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Bloomberg BusinessWeek



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What's it like to have The Oracle as your biggest shareholder? CEOs share the good and bad that comes with answering to Warren

BY ALICE SCHROEDER



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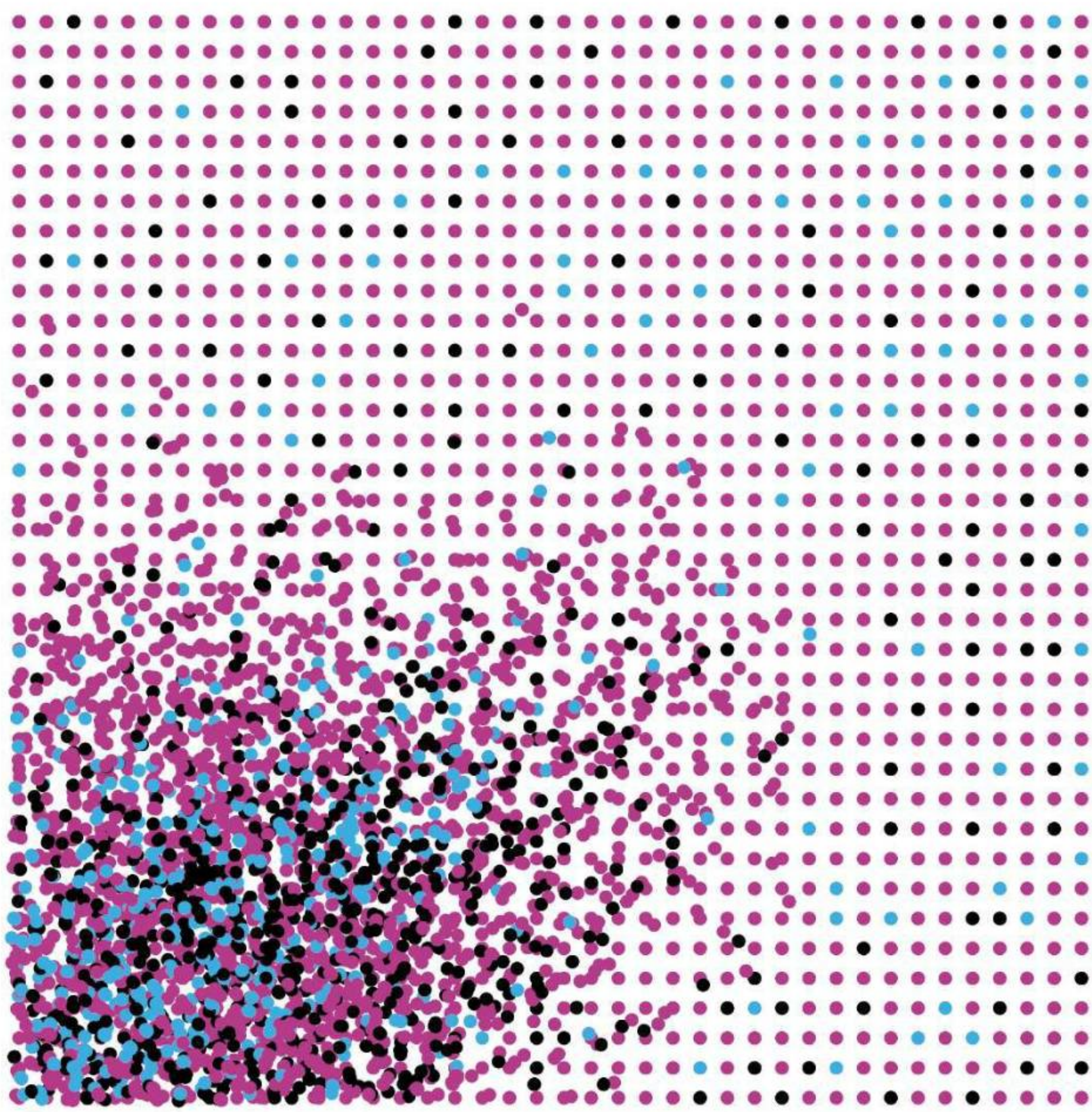
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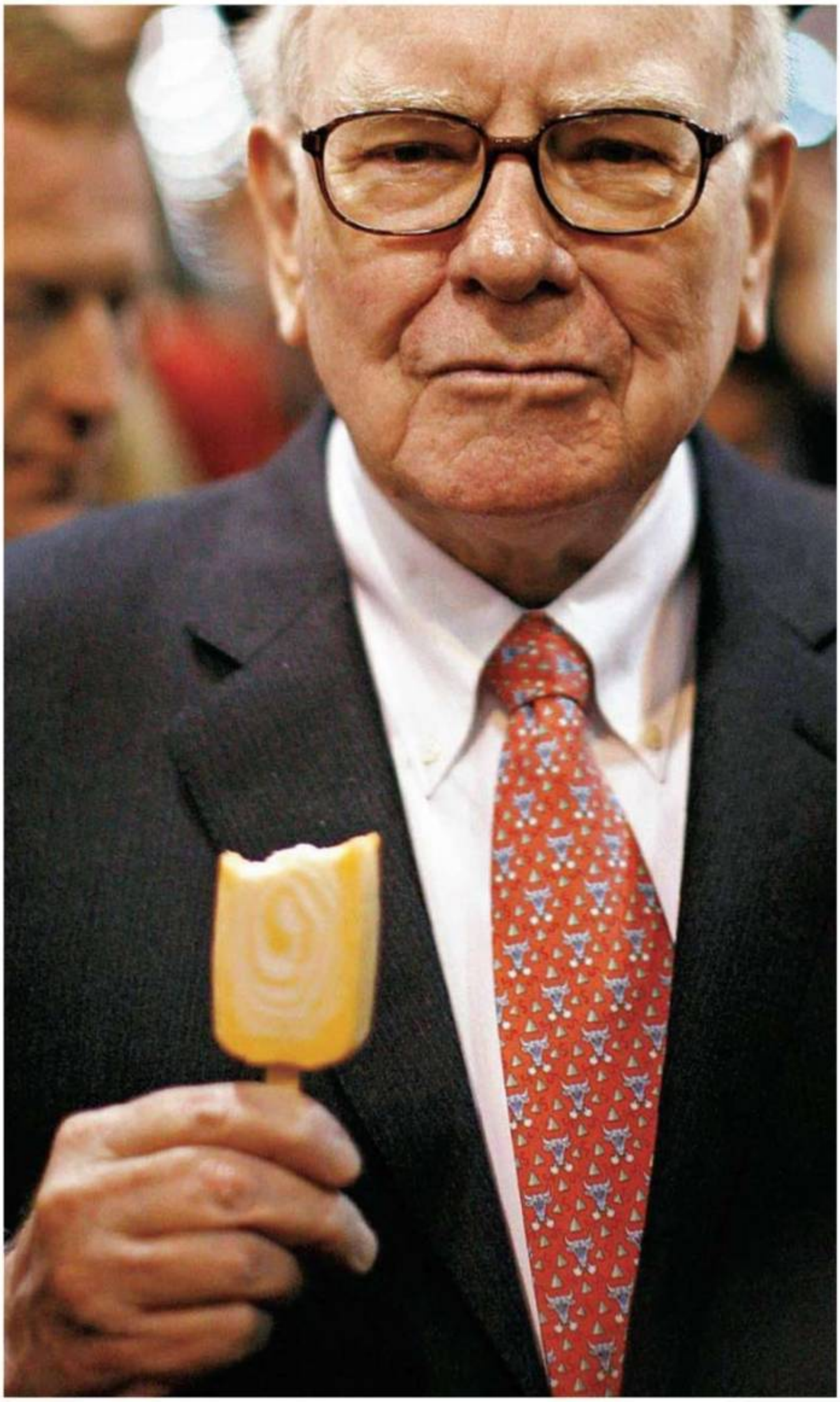
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Bloomberg BusinessWeek In Depth



COVER IMAGE BY DAVID YELLEN; (THIS PAGE) CARLOS BARRIA/REUTERS

Buffett at Berkshire Hathaway's 2009 annual meeting

30 | Please Hold for Mr. Buffett

What's it like to have America's greatest investor as your shareholder? Warren Buffett's biographer talks to CEOs who laud his patience and ability to quickly grasp financial complexities. His advice, they say, is priceless. Just don't make a deal he doesn't like.

39 | Investing Secrets Of Google Alums

Roughly 50 ex-Googlers—multimillionaires all—have put their financial might behind 200 fledgling companies. Many of their investments are both risky and potentially very rewarding. Expect their bets, which so far include Twitter and Tesla Motors, to shape the next wave of innovation.

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Bloomberg BusinessWeek The Global Report



OMB chief Peter Orszag

The Week in Business

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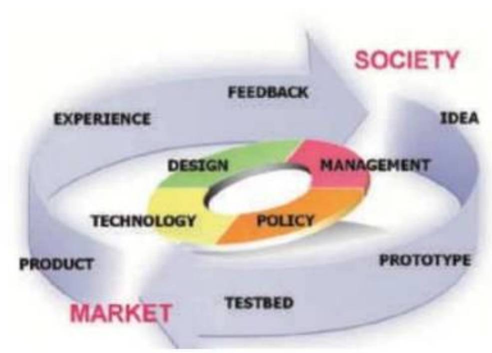
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THE WEEK IN BUSINESS



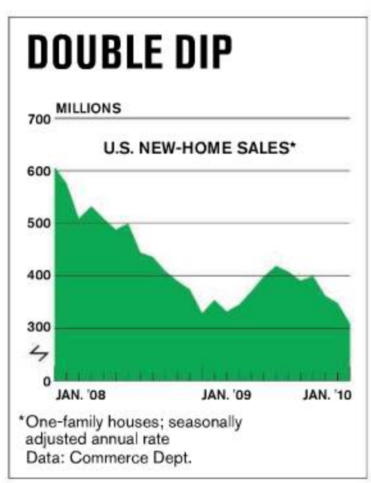
ECONOMICS & POLICY

TOYODA-*SAN* SPEAKS

Toyota CEO Akio Toyoda submitted to a Washington-style grilling on Feb. 24. The grandson of the company's founder took a seat before the **House Oversight & Government Reform Committee** and confessed bluntly that the carmaker's growth outpaced its ability to control quality. "I would like to point out here that Toyota's priority has traditionally been the following: first, safety; second, quality; and third, volume. These priorities became confused, and we were not able to stop, think, and make improvements as much as we were able to before." The day before, **James Lentz,** president and COO of **Toyota Motor Sales USA,** said that Toyota didn't do a very good job of collecting vehicle complaints from customers in different regions, which Representative Edward Markey (D-Mass.) deemed "unacceptable." Lentz also said that Toyota executives in the U.S. could not order a recall without approval from their bosses in Japan. He also admitted that while Toyota believes electronics aren't the problem, he could not guarantee that the floor mats and accelerator pedals the company has replaced will prevent future accidents.

WHAT RECOVERY?

Bad U.S. economic stats are piling up, making it more likely that the 5.7% GDP growth rate in the last quarter of 2009 was anomalous. On Feb. 24, the **Commerce Dept.** said sales of new homes fell 11% in January to the lowest level since record-keeping began in 1963. Core consumer prices,



Toyota CEO Akio Toyoda and North American chief Yoshimi Inaba

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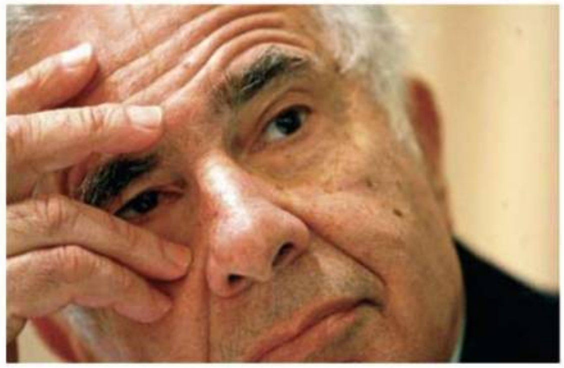
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EXECUTIVE SUMMARY

excluding volatile food and energy, fell 0.1% in January, the first monthly decline since 1982. The **Conference Board's Consumer Confidence Index** plunged a surprising 11 points in February, to 46. In the face of such weakness, **Fed Chairman Ben Bernanke** called the recovery "nascent" in congressional testimony on Feb. 24 and repeated a pledge to keep the federal funds rate "exceptionally low... for an extended period." The same day, the Senate passed a $15 billion bill that gives employers a temporary tax break for hiring people who have been out of work for at least 60 days. That's a tiny sum, though, for an ailing $14 trillion economy.

HEALTH REFORM REDUX

President Barack Obama unveiled the latest iteration of health care reform on Feb. 22 in an effort to stiffen the backbones of wavering Democrats and prod Republicans toward compromise. The bill differs slightly from last year's Senate version in that it would delay the start of a tax on high-priced "Cadillac" health plans from 2013 to 2018 and would levy the first ever Medicare tax on capital gains. Obama also wants a new panel that could monitor and curb insurance rate increases it deems unreasonable, a response to the 39% rate increase just proposed by **Anthem Blue Cross** in California. Some GOP legislators complained that the plan's release undermined efforts to find common ground at a bipartisan health-care confab called by the President for Feb. 25.



Activist investor Icahn nominated himself and three associates to Genzyme's board

STRATEGY

ICAHN'S NEXT TARGET

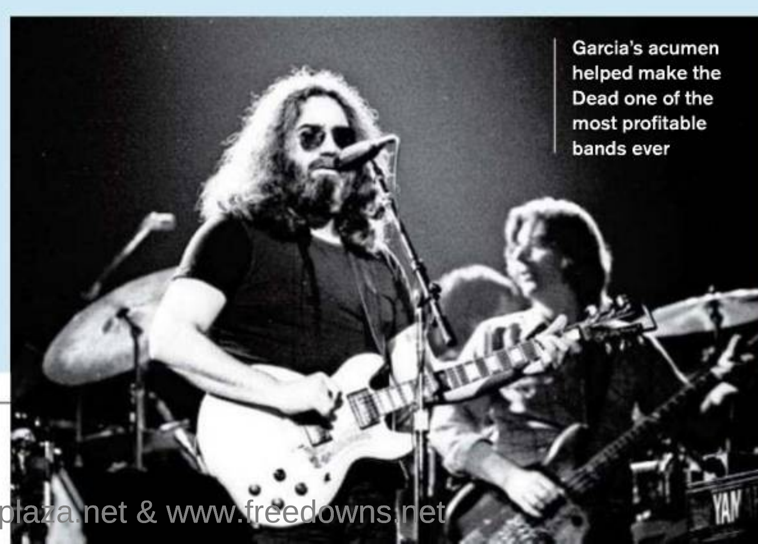
The latest CEO to feel the chill wind of Carl Icahn's scrutiny: **Henri Termeer,** head of **Genzyme,** one of the top five U.S. biotech outfits. The company said on Feb. 22 that Icahn will nominate four directors, including himself, to Genzyme's board. The election will take place at the annual meeting on May 20. During his 23 years at the helm, Termeer has built Genzyme from a startup to a $4.5 billion giant,

IDEAS WHAT A LONG, STRANGE BUSINESS PLAN IT'S BEEN

The notion that C-suite executives may have something to learn from **Jerry Garcia,** a man who preferred tie-dyed over tailored, may seem a tad trippy. Not so, says **Joshua Green,** whose article "Management Secrets of the Grateful Dead" appears in the March issue of *The Atlantic*. Green writes that while the band has long been a subject of academic inquiry, only recently have business theorists weighed in. **Barry Barnes,** a professor at Nova Southeastern University in Florida, describes the Dead as "masters of creating and delivering superior customer value." The band lavished special attention on loyal fans known as Deadheads. It created a telephone hotline to alert them of tour dates ahead of public announcements, and reserved some of the best seats for them, which it distributed through its own mail-order house. Green notes that it wasn't until the 1980s that American companies—faced with competition from Japanese rivals—adopted a customer-first mindset.

The Dead, one of the most profitable bands of all time, incorporated early on, complete with a board of directors. It established a lucrative merchandising division and took legal action against copyright violators. But it allowed fans to tape their shows, thereby sacrificing a potential revenue source. Writing in *Wired* magazine in 1994, the band's lyricist, **John Perry Barlow,** noted that "the best way to raise demand for your product is to give it away." That's essentially the same principle **Chris Anderson** explores in his recent book *Free: The Future of a Radical Price*.

The Atlantic

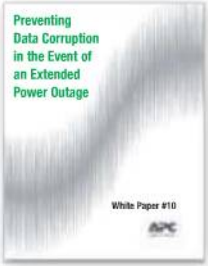


Garcia's acumen helped make the Dead one of the most profitable bands ever

(FROM TOP) MICHAEL NAGLE/GETTY IMAGES; MICHAEL OCHS ARCHIVES/GETTY IMAGES

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A 24-hour strike by Lufthansa pilots over labor rules caused 900 cancellations

THOMAS LOHNES/AFP/GETTY IMAGES

but lately it has suffered manufacturing snafus and investor dislike of its diversification strategy. Its stock is languishing near a five-year low. Icahn is known for pressing companies to unload assets or sell themselves entirely. Genzyme said it would "welcome a constructive dialogue."

0.1%

Drop in U.S. core consumer prices in January, the first monthly decline since 1982

Data: Labor Dept.

AN OIL-PATCH MARRIAGE

Oil services giant **Schlumberger** raised eyebrows with its Feb. 21 agreement to buy **Smith International.** The $11 billion, all-stock deal would give Smith shareholders a 37.5% premium. Analysts figure the price is on the high side, since oil services companies—which have done nearly all the field work since Big Oil divested its own drilling units in the late 1980s—operate on profit margins of roughly 15%, middling in terms of the industry's historic returns. But there are few better options in the oil patch these days, and the deal would boost Schlumberger's revenues to twice those of rival **Halliburton.**

UNFRIENDLY SKIES

About 900 **Lufthansa** flights were scrubbed after pilots staged a 24-hour walkout on Feb. 22 to protest labor rules. The next day, French air-traffic controllers angry about EU plans to overhaul the system began a five-day strike that caused thousands more cancellations and countless delays. On Feb. 24, **British Airways** cabin crews voted to go on strike over wage issues, while Greek air-traffic staff walked off the job to protest government budget-cutting plans to trim the country's debt.

COKE GOES AFTER COKE

The Wall Street Journal reported on Feb. 24 that **Coca-Cola** is on the verge of a $15 billion deal to swallow most of its largest bottler. Coke would buy the North American operations of **Coca-Cola Enterprises,** which would in turn purchase bottling operations in Scandinavia and Germany. The boards of both companies were scheduled to meet to O.K. the transaction, said the *Journal*. A deal would reverse Coke's decades-long strategy of maintaining bottlers as independent operations. **PepsiCo** made a similar move earlier, paying $7.8 billion for its two largest bottlers.

TECHNOLOGY

THE EU VS. GOOGLE?

Fresh off a showdown with China, Google could soon be scuffling with the European Union. On Feb. 24 the **European Commission** said it's examining three complaints from companies that accuse Google of demoting links to their sites in search results. Google controls nearly 80% of the Web search market in most large European countries, a higher share than in the U.S., and the company says it complies with laws governing competition. Meanwhile, six weeks after Google announced that it may withdraw from China, the world's largest Internet market, because of a clash with the government over censorship, the company appears to be having second thoughts. It's making local hires, introducing new services, and luring back skittish advertisers. Local experts say concerns that Beijing will push for a shutdown are easing. Google is recruiting for more than 30 posts in China, including engineers, managers, and sales staff, according to its Web site.

| BW | PAGE 39 "And Google Begat..."

THE OPTIMISM METER

SLOWER GROWTH AHEAD?



The Meter fell one point, to 45, during the week ended Feb. 23, as the share of Americans who say they think the economy is getting worse increased from 34% to 40%. Developed by ***Bloomberg BusinessWeek*** using data from pollster **YouGov,** the Meter is a proprietary measure of sentiment and expectations, economic statistics, and market forecasts. It evaluates shifts in outlook among individuals, professional investors, and economists in the areas of U.S. economic growth, jobs, equity markets, and real estate.

Calculated using consumer polling, economic forecasts, and financial markets data; 0=lowest and 100=highest Data: YouGov, *Bloomberg BusinessWeek*

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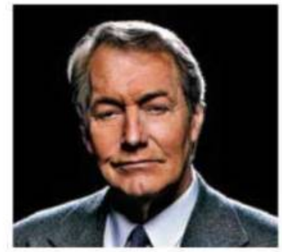
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AT THE TABLE CHARLIE ROSE





Orszag preparing to testify before the Senate on Obama's 2011 budget

(FROM TOP) BRAD TRENT; MICHAEL REYNOLDS/EPA/CORBIS

PETER ORSZAG
Putting the Deficit on a Diet

Peter Orszag is playing a more prominent policy role than directors of the Office of Management & Budget have in the recent past. He helped design the Administration's $787 billion stimulus plan and the health-care-overhaul bill now before Congress. As the economy has stabilized, he's begun tackling the gargantuan deficits that threaten America's fiscal stability. This is an edited version of a conversation televised on Feb. 24.

CHARLIE ROSE
You have always considered health-care reform as a tool in deficit reduction.

PETER ORSZAG
Yes. As you go out over the long term, there is nothing else we can do. I don't care what revenue proposal you have, what Social Security proposals you have, what proposals you have to reduce discretionary spending—none of that will matter unless we reduce the rate at which health-care costs grow.

Health-care costs are what percentage of GDP?
Currently, overall health care is about 16% of GDP. It is projected to rapidly increase. In 10 years, it will increase by a few percentage points as a share of GDP. But the issue is it continues thereafter. And the thing that's important about the bills under consideration—the single most important thing we can do—is to move the incentive system for providers, hospitals, and doctors away from paying for more stuff. The problem is that we currently do not know exactly how to design

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Obama with fiscal reform commission co-chairs Bowles and Simpson

that system. Even if I appointed you dictator today, you would not have the knowledge to just snap your fingers and take 16% of the economy and transform it immediately to a fee-for-value system. So what we need to do is be aggressively testing out different approaches ... and then have a way of moving rapidly as we learn which approaches are more promising.

One of the things Republicans always say is, why doesn't the White House want to make a deal about tort law? The President says he's open to every idea, so why is it a big thing to say "I'm open to medical malpractice reform"?
I guess I'd push back and say, if that's the deciding issue, then let's see a comprehensive plan that says, with this additional piece, we now sign on.

You're just putting the ball in the other guy's court. Rather than suggesting alternatives on which you might find common ground, all you're saying is, show me your idea and I'll react to it.
One thing I would note on medical malpractice is that the same people who criticize the existing bills for not reducing costs sufficiently, not reducing the deficit sufficiently, use the Congressional Budget Office as the basis for reaching those judgments. The CBO has said most of the medical malpractice reforms out there don't do much to reduce costs. Plus, what exactly does medical malpractice reform mean? Put it on the table.

Are you telling me that at this stage of the game there have not been those kinds of discussions? Health care has been one of the President's primary domestic goals since the Inauguration.
And the President has put forward a specific plan that expands coverage, reduces the deficit, and will put in place an infrastructure that will help contain costs. Let's not forget that if we don't get health reform done now, I don't know that anyone's going to be willing to try again for a very long time.

So what is the outcome the Administration wants?
A bill that reduces the deficit over time, that expands coverage so that fewer Americans face the health and financial risks associated with no insurance, and that puts in place the key infrastructure that will help move to a higher-quality system over time.

Why is American health care a larger percentage of GDP than in any other industrial economy?
One study suggests the higher costs are partially because we are more intense users of technology and partially because we pay more to doctors. Cross-country comparisons suggest that a very large share of health costs in the U.S., perhaps as much as 30%, don't actually improve health outcomes. But I would say that if you face a complicated medical condition, the reason you see foreigners often traveling to the U.S. is that our top medical facilities are the best in the world.

Can you learn anything from a Cleveland Clinic or a Mayo Clinic?
Absolutely. This is the stunning part. We have examples in the U.S. of world-class medicine being delivered at much lower costs than at other institutions. And if we can move toward the practice norms that exist at Cleveland and at Mayo, we would not only have higher quality, we'd have lower costs, too.

Will the deficit commission the President has created work?
I think it will. We have Alan Simpson and Erskine Bowles, a Republican and a Democrat, who know the issues and know Washington and are willing to work hard on a bipartisan basis. Is it 100% guaranteed that it will work? Absolutely not.

Most people look at the commission and say no Republican will buy into anything that talks about a tax increase. And anything that talks about serious spending cuts—certainly on safety-net programs—no Democrat will buy into.
That needs to change, because if it doesn't, we will ultimately wind up with a fiscal crisis. The Administration has been very clear. Everything has to remain on the table.

What do you think the commission might come up with?
Hopefully with a set of proposals that reduce the deficit to no more than 3% of the economy by 2015.

THE CBO HAS SAID THAT MOST OF THE MEDICAL MALPRACTICE REFORMS OUT THERE DON'T DO MUCH TO REDUCE COSTS

But can you do that without an austerity program and a tax program?
The issue is not writing down ways to get there. The issue is building a coalition that supports a particular approach. Maybe they'll come upon some new solutions. That would be great. But the problem is how do you bring people together around an approach, choosing from one of several that are out there? |BW|

Watch Charlie Rose on Bloomberg TV weeknights at 8 p.m. and 10 p.m.

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BUSINESS OUTLOOK | RICH MILLER

WHY THE 'D' WORD IS BACK ON THE TABLE

Prices for core goods and services in the U.S. recently slipped to last fall's levels. While that caused some cheer on Wall Street, it could signal a bigger worry: deflation

Investors applauded the latest inflation news on Feb. 19. Despite a surge in the cost of gasoline and other energy products, consumer prices rose just 0.2% in January. Perhaps more important, core consumer prices—which exclude volatile food and energy costs and which are considered indicative of underlying inflation trends—actually fell 0.1% during the month. The news quelled financial market fears that the Federal Reserve would be forced to raise interest rates soon to keep inflation in check.

0%

Change in core U.S. consumer prices in the three months through January

Data: Labor Dept.

Investors would do well to curb their enthusiasm. Only months after its supposed demise, analysts are beginning to whisper the "D" word again. "Recent declarations of 'mission accomplished' in the fight against deflation risks now look somewhat premature," says Michael Feroli, an economist at JPMorgan Chase.

Deflation, even just the whiff of it, is something to be feared, not cheered. If widespread price declines take hold, they can be particularly debilitating for the economy. Faced with the prospect of depressed prices for products, companies are unlikely to expand operations or add workers. Falling prices also give already shell-shocked consumers yet another reason to hold on to their cash. Why buy something today that will cost less tomorrow?

What's more, deflation would be devilishly difficult for Fed Chairman Ben Bernanke and his colleagues to deal with. The lower prices fall, the higher inflation-adjusted interest rates rise, further reducing the willingness of companies and consumers to borrow and spend. The last time monthly core prices fell was in December 1982. The drop then was welcome news: It came at the end of a year when inflation clocked in at 6.2%, after a 10.3% reading in 1981. In sharp contrast, this January's decline occurred when inflation was already low. Overall consumer prices slipped 0.4% last year, largely the result of plunging energy costs.

The January drop left core consumer prices essentially unchanged from where they were in October. Over the last year, they've risen just 1.6%, well below the 10-year average of 2.2%.

Shelter costs—primarily the expense of renting or owning a home—have been a major factor in damping inflation. That's not surprising, given that they account for about one-third of the consumer price index (CPI). That has led some analysts, including James Bianco of Chicago-based Bianco Research, to argue that inflation has been distorted downward by the housing bust and its aftermath.

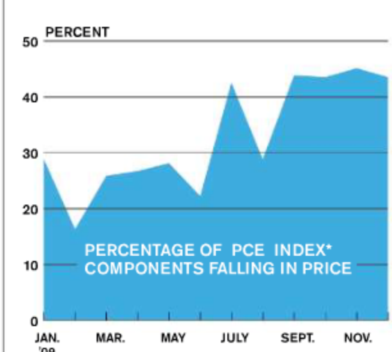
It's not only housing costs that are deflating. Prices on 44% of the products and services covered by the government's personal consumption expenditure price index—everything from personal computers to parking fees—fell in December, the latest data available at press time (chart). That index gives less weight to shelter costs than the CPI, so it's seen by the Fed as a more accurate measure of inflation.

The real culprit behind the disinflationary trend: the huge amount of slack left in the economy after the Great Recession. U.S. industry operated at just 72.6% of capacity in January, up from a 40-year low of 68.3% last June but far below the 81% monthly average since 1967. With that much spare capacity still around, companies can't raise prices without running the risk of losing business to competitors.

That slack won't disappear soon, even with the economy in recovery. Janet Yellen, president of the San Francisco Fed, says it will take until 2013 for the economy to rev back up to its full potential.

Even so, some signs of inflationary pressures are emerging. Commodity and import prices are on the rise, spurred by a China-led boost in global demand. Raw material costs at U.S. companies jumped 9.6% in January, the most in three years. But wages, which with pensions and other benefits make up two-thirds of the cost of doing business, remain under wraps, held down by sky-high unemployment. Labor expenses rose at an annual rate of 1.5% in the fourth quarter. That's no recipe for robust recovery. The ingredients for a deflationary mix are still on the table. | BW |

DEFLATION DANGERS?



*Personal Consumption Expenditure Price Index
Data: Commerce Dept., Dallas Federal Reserve Bank, Bloomberg Calculations

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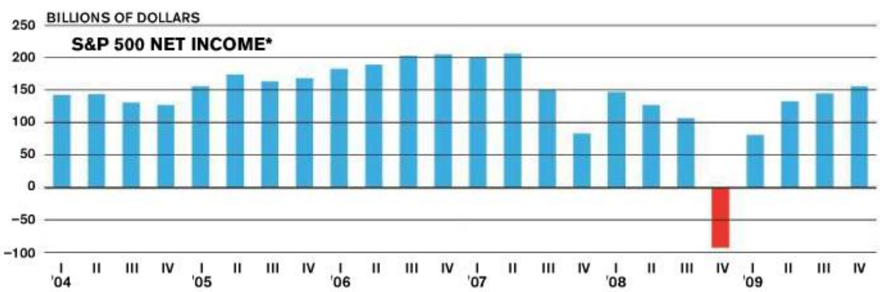
NUMBERS

EARNINGS IN AMERICA: THE WRECKAGE AND THE RECOVERY

By Tara Kalwarski/Charts by David Foster

S&P 500 companies made about $153 billion in net income in the fourth quarter, bringing 2009's total to more than $500 billion—a vast improvement over 2008. But some, including ExxonMobil, actually posted lower fourth-quarter profits than a year earlier.

What a Difference a Year Makes: Fourth-quarter profits for S&P 500 companies were $153 billion, vs. a loss of $93 billion a year earlier.

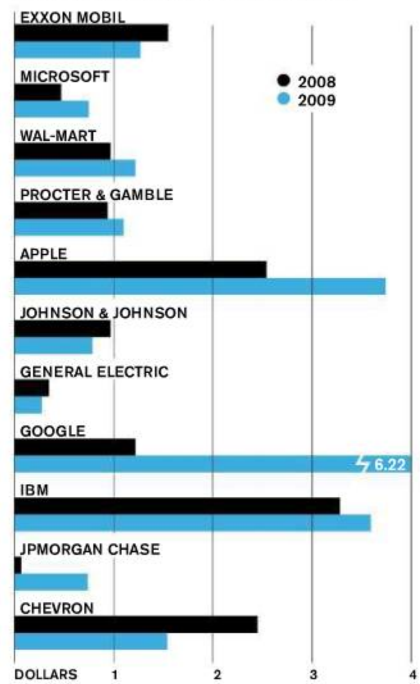


Data: Bloomberg

*As of Feb. 22

Big-Name Losers: Four of the 10 most valuable companies in the U.S. reported lower earnings per share in 2009 vs. a year earlier.

FOURTH-QUARTER EARNINGS PER SHARE AT AMERICA'S BIGGEST COMPANIES*

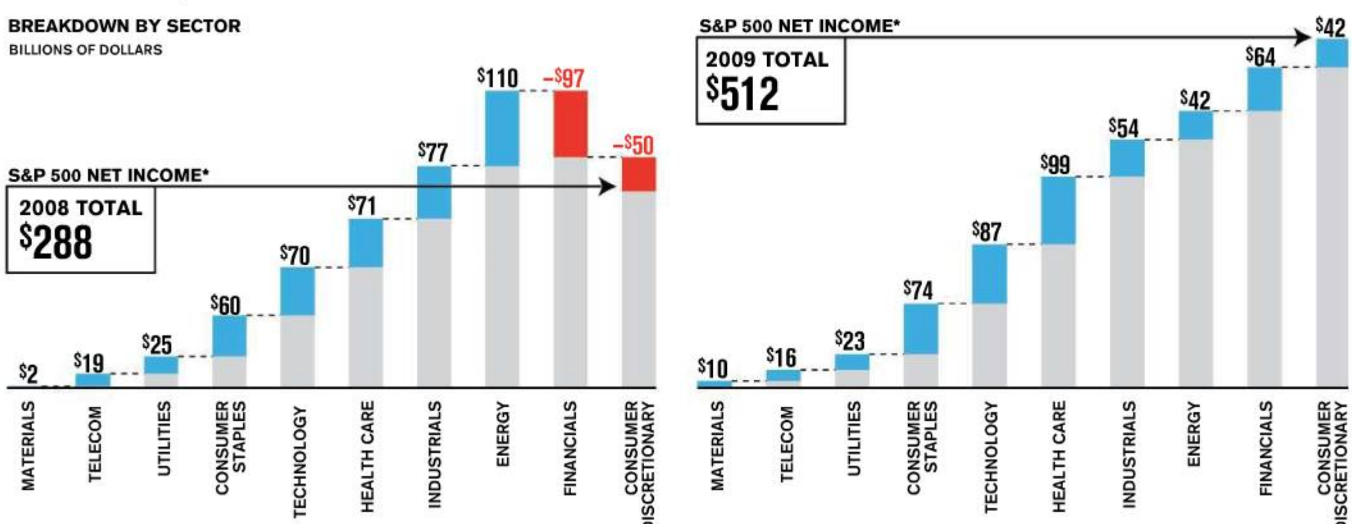


*Ranked by market capitalization; data are for companies that had reported fourth-quarter results for calendar year 2009 as of Feb. 18.
Data: Bloomberg

WHERE THE GAINS ARE

In 2008 losses at financial and consumer-discretionary companies dragged down S&P 500 profits. Those two sectors rebounded in 2009.

BREAKDOWN BY SECTOR
BILLIONS OF DOLLARS



*As of Feb. 22
Data: Bloomberg

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NEW BUSINESS



PETE SOUZA/OFFICIAL WHITE HOUSE PHOTO

How Gridlock Might End

Midterm elections have both parties rethinking their strategies. And therein lies an opportunity for some real dealmaking

By Paula Dwyer

In Washington's current state of dysfunction, everyone has a favorite hyper-partisan moment. House Republican Whip Eric Cantor's moment came at a White House meeting with congressional leaders on day three of the new Administration. He handed President Barack Obama a list of ideas to fix the economy. Pointing to a small business tax-cut item, Obama said: "We disagree on tax policy." When Cantor tried to justify his own position, Obama responded: "Elections have consequences, and at the end of the day, I won."

Since then, Republicans have made it their mission to prove that Obama's 53% popular vote may have put him in the White House, but it didn't give him the final word on fundamental economic policy debates. The GOP's coordinated resistance has derailed treasured Obama legislative priorities such as financial regulation, carbon credits, and, above all, health care.

The resulting gridlock has cost the President much of his popularity, particularly among independents. A Jan. 31-Feb. 3 Iowa Poll, conducted for the *Des Moines Register* by Selzer & Co., has Obama's approval rating among Iowa independents at 38%, down 10 points since November. Remember that it was Iowa independents whose support for Obama in the 2008 caucuses vaulted him to the front of the Presidential pack.

Confronting an inflection point in his Presidency, Obama has begun to recalibrate. He put in an appearance at a retreat of House Republicans in late January and set the table for the bipartisan health summit on Feb. 25 with a plan that omits the public option much loved by liberal Democrats. Over some of his own party leaders' objections, he used executive power to create a deficit-reduction commission, naming a moderate Democrat (Erskine Bowles) and a former Republican senator (Alan Simpson) as co-chairs. And Eric Cantor take note: Obama even backed tax cuts for small business in the scaled-down $15 billion jobs bill the Senate passed Feb. 24, with the support of 13 Republicans.

Such moves have had the intended effect. On Feb. 22, in a rare show of bipartisanship, five Republican senators crossed the divide to join Democrats in agreeing to debate the jobs bill, a real achievement in this climate. "In campaigning, every day you have to get up and destroy your opponent," says Kenneth M. Duberstein, who was White House chief of staff under President Ronald Reagan in 1988-89. "In governing, every day you have to get up and make nice to your opponents."

Of course, building bipartisan coalitions also requires lawmakers will-

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Obama has involved himself more in the process of drafting legislation

ing to buck their parties. Luckily for Obama, a handful of Republicans—mindful that rejecting every White House idea is not an effective campaign strategy—have started to work with Democrats on issues ranging from tax policy to education reform to financial regulation overhaul. They may have political motivations, but that doesn't mean Obama can't exploit them.

Consider Senator Bob Corker, the first-term Tennessee Republican who rocketed out of back-bench obscurity last year when he tried to forge a deal with Democrats on a rescue package for Detroit automakers. That effort failed, but Corker is at it again, working with Senator Chris Dodd, the retiring Connecticut Democrat, on financial regulation reforms after the Senate Banking Committee's senior Republican, Alabama Senator Richard Shelby, failed to find common ground. Now that Corker has stuck his neck out, the White House may need to compromise over its demands for a stand-alone consumer financial protection agency and a new out-of-court, wind-down process for failing institutions, both of which Corker opposes.

Of the five Republican senators who voted to allow debate on the jobs bill, it's noteworthy that two are retiring after this year—Kit Bond (Mo.) and George Voinovich (Ohio). Their parochial interest was the bill's reauthorization of the highway trust fund, freeing up billions of dollars for construction projects. But they're proof that it's a lot easier to be bipartisan if

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Obama and House and Senate leaders discussed working together in February

you're no longer running for office.

And therein lies an opportunity. Senator Judd Gregg, the New Hampshire Republican who at first accepted and then rejected Obama's offer to be his Commerce Secretary, is also standing down—and reaching out to Democrats. Working with Senator Ron Wyden, an Oregon Democrat, Gregg is pushing a tax reform proposal two years in the making. A central element would be a flat corporate tax rate of 24%, down from the 35% top levy now, and the elimination of special tax breaks. At the same time, Gregg and Wyden would put a halt to the indefinite deferral of U.S. taxes on overseas income by multinationals and simplify personal income taxes by reducing the number of brackets from six to three and allowing most Americans to file a one-page form.

Gregg said he and Wyden "negotiated this endlessly" and, in the end, he agreed to a higher capital-gains tax rate—35% vs. today's 15%—in exchange for lower personal and corporate income tax rates. That's the kind of give-and-take the Obama Administration has not engaged Republicans in, Gregg says, especially on health care. "With super-majorities in the House and Senate, they made a conscious decision to run the government like a parliamentary system and went aggressively to the left. It turned out some of their own members couldn't accept that."

As the Administration is learning, process matters. Early on, Obama mistakenly shied away from participating in the drafting of health-care legislation, says Robert D. Reischauer, president of the left-leaning Urban Institute and a former Congressional Budget Office director. In nearly a year of debate and trench warfare, it was not until Feb. 22 that Obama put his name on a health measure. Until that point, the process resulted in unsavory backroom deals and "gave sausage-making a bad name," Reischauer says.

Alan Simpson also blames mistakes in process for the sclerotic pace of partnership. Presidents Jimmy Carter, Ronald Reagan, and George H.W. Bush "always sent up a draft" for new initiatives, said the blunt-speaking former senator who hung up his spurs in 1997. "Turning over the management to liberals in Congress" was Obama's biggest mistake, Simpson says. House Speaker Nancy Pelosi and Senate Majority Leader Harry Reid are his friends, he says, "but all they wanted to do was ram legislation through. No one on the other side is going to accept their proposals any more than liberals would from arch-conservatives."

IT'S EASIER TO BE BIPARTISAN IF YOU'RE NOT RUNNING FOR OFFICE. SOME WHO ARE STANDING DOWN ARE REACHING OUT

Still, there are budding signs that some conservative Republicans are willing to deal. The late Senator Edward M. Kennedy often co-sponsored health-care bills with Senator Orrin Hatch, the Utah Republican. While Hatch refused to play ball with the Democrats on health reform, he just paired up with Senator Chuck Schumer, the New York Democrat and one of the Senate's more partisan warriors. Together they devised the small business tax breaks in the jobs bill, including the Social Security tax holiday through December for companies that hire the unemployed.

Then there's Senator Scott Brown, whose upset win in the Massachusetts special election to fill Kennedy's seat left Obama without a filibuster-proof majority in the Senate. Brown, who never identified himself as a Republican during the campaign yet is revered by the Tea Party movement, said he planned to be an independent voice in Washington. So far at least he seems to have meant it; he voted for the jobs bill.

Obama can continue to tack toward the middle, and electoral-minded Republicans in moderate states may well try to meet him there. On the other hand, the President could throw up his hands and invoke reconciliation on health reform, a budgetary maneuver that would allow congressional passage with a simple majority vote. While that would enable Democrats to bypass Senate Republicans, it risks setting off a nuclear winter.

It would certainly make life a lot easier for all if there were more legislators willing to follow Simpson's example. He often worked across party lines on budget accords in years past. But at the White House on Feb. 18, as he stood behind the President at the announcement of the deficit commission, wearing a big smile and a purple Jerry Garcia necktie (one of Simpson's first campaign co-chairmen was a Grateful Dead lyricist), he seemed oddly out of place, a throwback to an era when gridlock was the exception, not the rule. |BW|

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Doctor, There's A Pulse

Pulled from its death spiral by the bailout, AIG is seeing a pickup in its primary insurance businesses

By Hugh Son

American International Group will long be remembered as the towering insurance and financial services company that almost deep-sixed the U.S. economy. Following a near-death experience in 2008, the insurer has required a series of government bailouts totaling $182.3 billion. So here, for a change, is some news about AIG that won't make you cringe: The company is showing signs of a turnaround.

New York-based AIG was scheduled to report results on Feb. 26, a couple of days after *Bloomberg BusinessWeek* went to press. An expected fourth-quarter loss, stemming from more than $5 billion in charges tied to paying down debt, won't tell the whole story. Buried under the ugly numbers is evidence that AIG's primary insurance businesses are picking up. Consider that revenue at AIG's property-casualty businesses rose for three straight quarters last year after plunging 23% in the final three months of 2008. The unit, which has been rebranded Chartis, accounts for more than a third of the company's total revenue. Meanwhile, sales of life insurance and retirement products rose for the three months ended in September 2009, the first increase since the crisis.

Despite the dire predictions of many in the industry, it is even beginning to look like the 91-year-old company may manage to hang on to its position as the largest U.S. commercial insurer. "They've actually done a very good job of keeping the ship afloat," says James S. Tisch, CEO of Loews, which owns about 90% of rival insurer CNA Financial.

ASSET SALES

Robert H. Benmosche, the brash executive brought in last August to run AIG, needs to boost insurance profits to repay government loans. The 65-year-old former MetLife CEO, who declined to be interviewed, has said he will rebuild businesses damaged after losses at AIG's derivatives unit—called an unregulated hedge fund by Federal Reserve Chairman Ben S. Bernanke—sapped the parent of cash.

Once the world's largest insurer



ILLUSTRATION BY ROBERT NEUBECKER

by assets, AIG has shrunk by about a fifth since the government rescue. The company has retreated from asset management for institutional clients and the U.S. auto insurance industry, striking deals to sell businesses for a total of more than $12 billion. It has scaled back operations at its plane-leasing unit and plans to wind down its derivatives division by yearend. AIG also transferred stakes in its two biggest overseas life insurance businesses to the Fed to pay down its credit line by $25 billion.

Diminished is better than dead, though. Recall that AIG's stock plunged 97% in 2008. Lawmakers railed over retention bonuses paid to employees of the derivatives unit.

Business Exchange

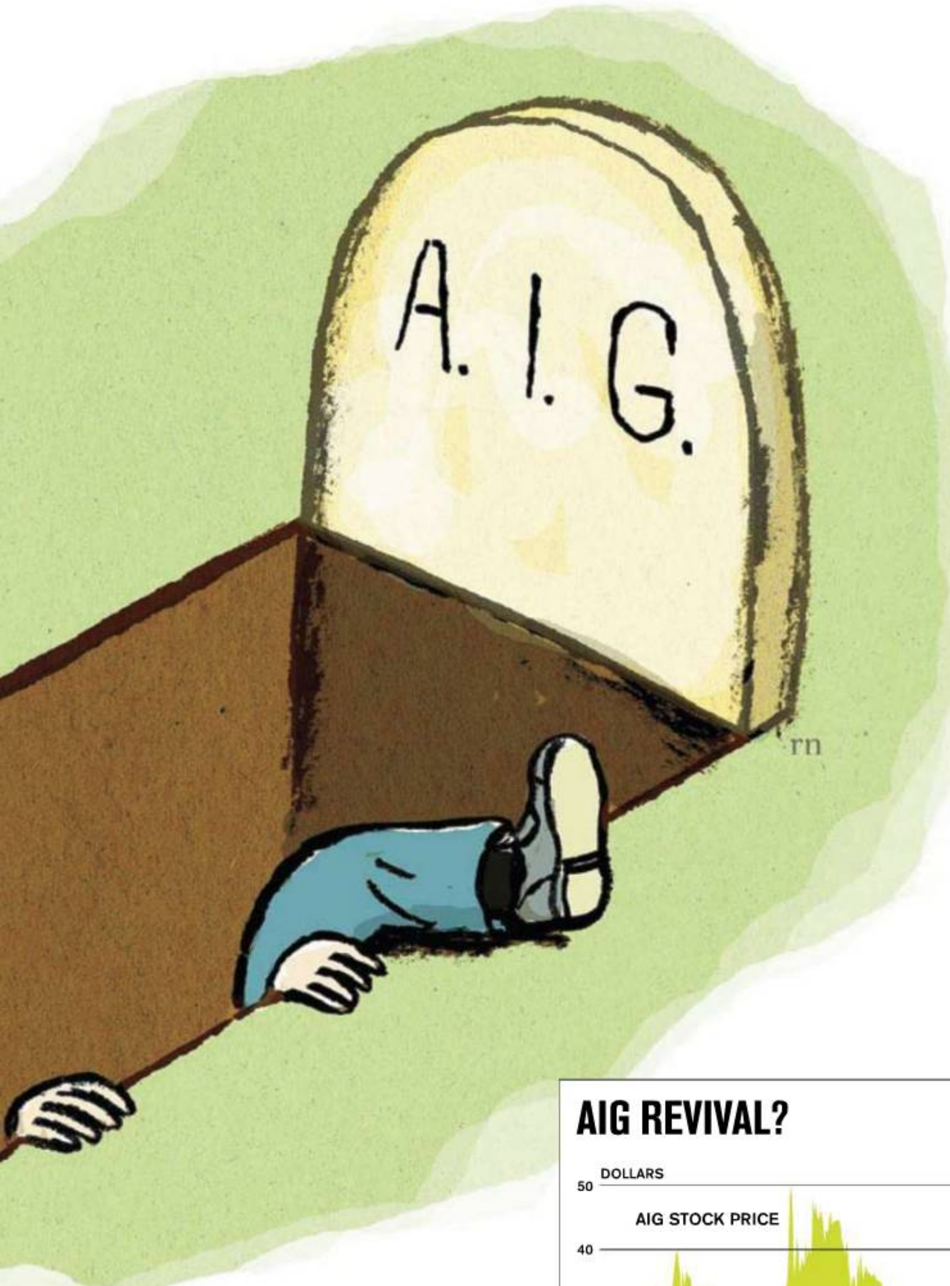
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Goldman and AIG: The Plot Thickens

A five-page document that the New York Fed fought making public for more than a year shows that the banks that turned to AIG to insure against losses on collateralized debt obligations were in most cases the same institutions that underwrote the securities, according to a Feb. 23 Bloomberg story. The CDOs minted by Goldman Sachs were especially toxic, with losses in some cases exceeding 75% of their notional value.

To read the story, go to http://bx.businessweek.com/aig/reference/

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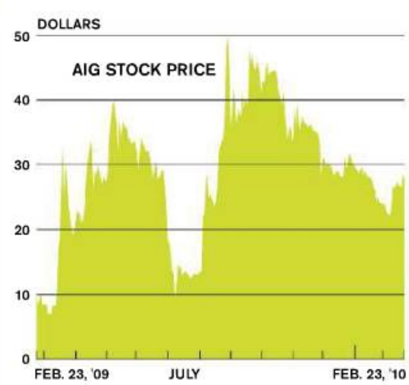


There was "concern that most of AIG's largest customers would flee entirely," says Robert P. Hartwig, president of the Insurance Information Institute, a trade organization in New York. "That didn't happen." In a research note published on Dec. 14, Barclays Capital analyst Jay Gelb reported that about 75% of insurance buyers using AIG said they plan to stay with the company.

Insurance buyers may be sticking with AIG partly because of the government's 80% stake in the company and its Fed credit line, says Shivan Subramaniam, CEO of FM Global, a commercial-property insurer in Johnston, R.I. "People view the federal government as being a backstop," he says.

Some competitors have a different view of AIG's renewed vigor. Chubb and Liberty Mutual Group say AIG is holding on to customers by slashing prices. These claims are being investigated by Joel Ario, the insurance commissioner for Pennsylvania, the state where the bulk of AIG's commercial insurance business is based. "We're very concerned about underpricing, because it can become a solvency risk," Ario says. "It's also true that companies are constantly complaining about their competitors pricing too low in a soft market." He declined to comment further on the probe.

AIG REVIVAL?



Data: Bloomberg

Says Mark Herr, an AIG spokesman: "We have not changed how we underwrite or price our business."

AIG is competing for a bigger share of a shrinking pie. U.S. property and casualty sales slipped 5% industrywide in the third quarter, the biggest drop since at least 1986, because of lower insurance rates and reduced demand. Annualized premiums for U.S. life insurers dropped 19% in the first nine months of 2009 from the same period the year before, according to trade group Limra International.

Surviving as a smaller company focused on insurance doesn't mean that AIG will be able to repay all its debt to taxpayers. The Government Accountability Office said in December that the U.S. will probably lose $30.4 billion on the bailout. The rescue included a $60 billion Fed credit line, an investment of as much as $69.8 billion from the Treasury Dept., and up to $52.5 billion in funds to pay Goldman Sachs and other counterparties to settle derivatives contracts and securities-lending obligations.

Hank Greenberg, 84, who ran AIG for almost four decades until 2005 and controls the largest stake after Washington through a closely held investment vehicle, argues that the government might have a better shot at recouping its money if it dialed back its holding to 20%. His contention: A company that is majority-owned by Uncle Sam cannot attract private investment. "Look, I hope they are stabilizing," Greenberg says. "We should renegotiate the terms of the bailout to make it more likely to repay taxpayers."

A sweeter deal for AIG is unlikely, given public outrage over executive pay and the cost of the rescue. Benmosche has said he will strengthen units before selling them to repay debts and limit federal involvement. Doing that will be a tough challenge—though not a bad state of affairs for a company that came close to corporate extinction 18 months ago. |BW|

–With Jamie McGee in New York

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The Pain in Spain Falls Mainly on the *Cajas*

Many nonprofit lenders face hard times even as the biggest commercial banks remain strong

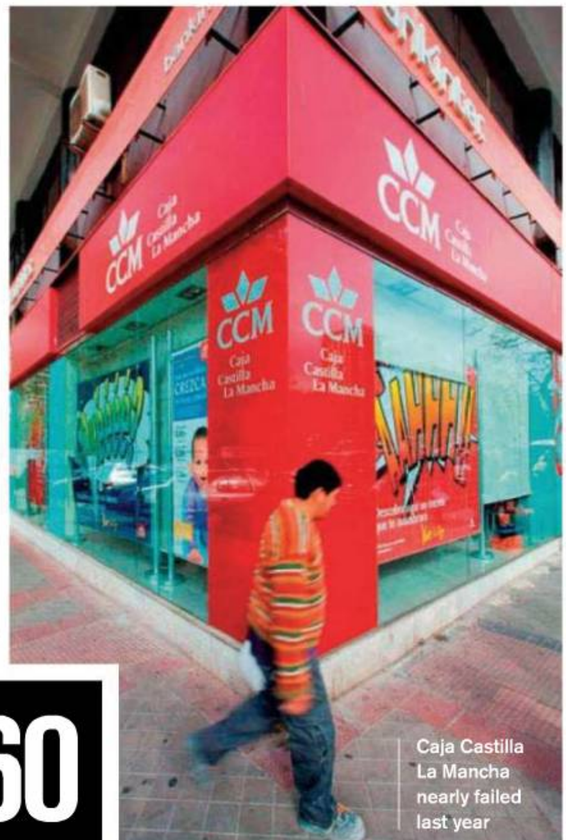
By Mark Scott

As Spain's economy faltered over the past year, outsiders marveled at the strength of financial giants Banco Santander and BBVA. How could the two largest banks have fared so well in such a troubled economy? The answer is that the pain has hit a separate category of bank: the *cajas*, nonprofit institutions that make roughly half of all loans in the country.

These banks—similar to savings and loan associations in the U.S.—eagerly served up credit as the housing bubble inflated over the past decade. Last September they had some $330 billion in loans to developers on their books, up from $50 billion in 2000, the central bank estimates. Today, nearly half of the *cajas*' $1.8 trillion in assets are mortgages or other real estate loans.

With home prices plunging, the 45 *cajas* are suffering. More than 7% of their loans could go bad this year, vs. 5.1% in 2009, according to the Spanish Confederation of Savings Banks, an industry group. Growing defaults "are a real concern," says Santiago Carbó, a finance professor at the University of Granada. Credit Suisse says the *cajas* might lose $3.4 billion this year.

The defaults could lead to a wave of foreclosures or writedowns that would further hobble Spain's anemic economy. Gross domestic product shrank 3.7% in 2009 and may contract an additional 0.8% this year, vs. a 2.2% expansion in the U.S., according to EU estimates. And there's little spare cash available for bailouts. The deficit is expected to hit 9.8% of GDP this year, and Madrid has announced $70 billion in budget cuts to bring the figure below 3% by 2013.



Caja Castilla La Mancha nearly failed last year

$860 billion

Value of real estate loans held by Spain's *cajas*

Data: Banco de España

To raise cash, the *cajas* are scrambling to sell properties they have seized as collateral, which could further pummel housing prices. "Everyone is trying to offload assets," says Robert Tornabell, former dean of ESADE Business School in Barcelona. "It's a war out there."

Smaller *cajas* rarely publish financial reports, so it's hard to know exactly how they're faring. But Mauro Guillén, a professor at the University of Pennsylvania's Wharton School, says the biggest problems are in southern Spain, where billions were plowed into seaside resort hotels and condominiums. "Many got caught up in the real estate gold rush," Guillén says.

Cajas typically have close ties to provincial governments, so they often face pressure to back projects that may not be profitable. A prime example is Terra Mítica, a theme park in the southern resort town of Benidorm. Partially owned by Bancaja and Caja Granada, the park went bankrupt in 2004 and has struggled since reopening in 2006.

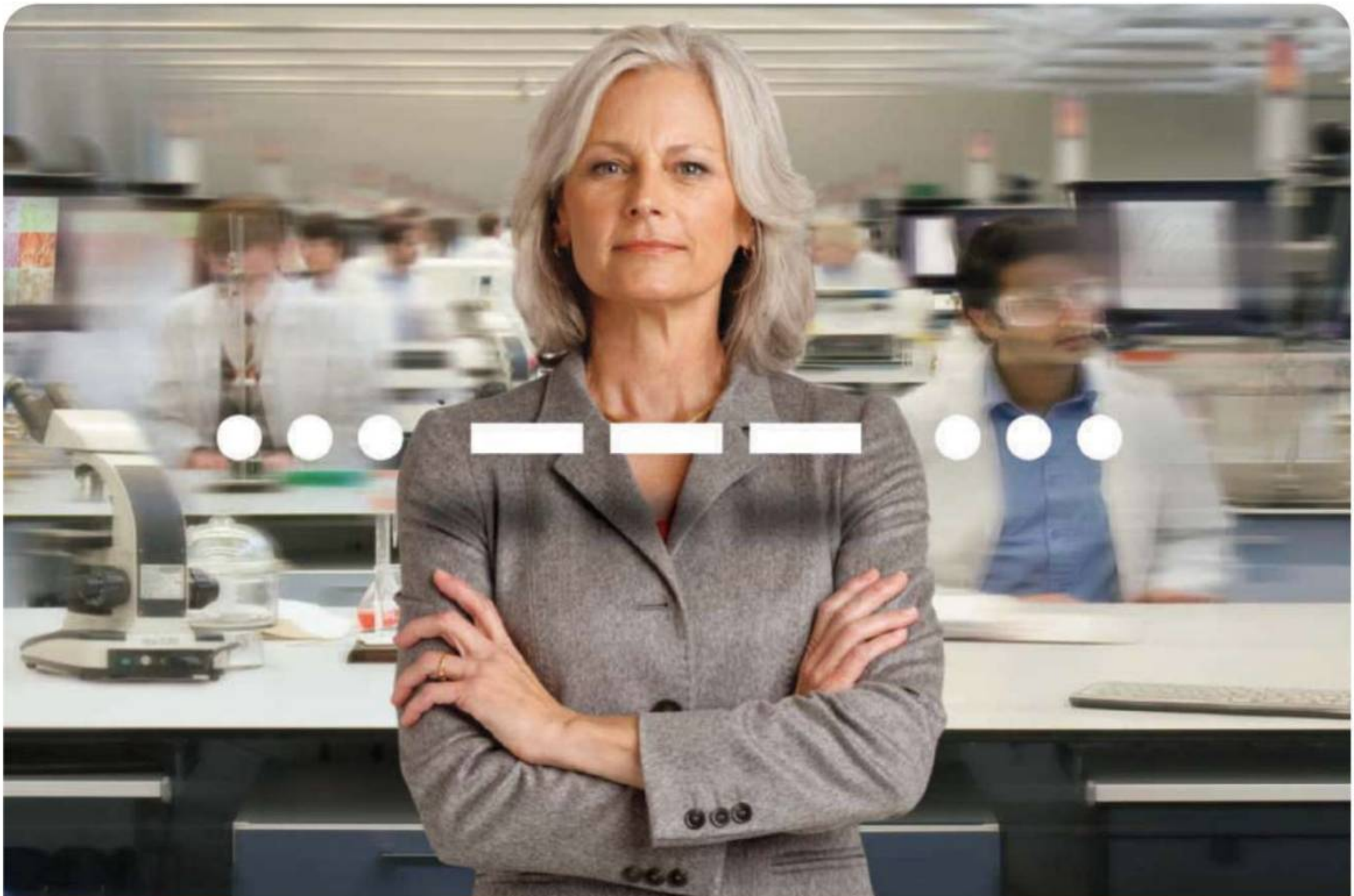
Second-tier commercial banks are also grappling with soured real estate loans, but the *cajas* have fewer options for solving their problems. As quasi-public institutions, they can't be purchased. So the most likely outcome for weaker players is a tie-up with a rival, and Madrid has offered $135 billion in long-term financing to *cajas* that merge. While many deals face opposition from provincial politicians, 24 *cajas*—with total assets of $470 billion—have indicated they plan to consolidate, according to ratings agency Moody's. "We are looking for partners to get stronger in Spain and [to expand] abroad," says Enrique Goñi, chief executive of Pamplona-based Caja Navarra, which is working on mergers with two smaller rivals.

The two biggest players, meanwhile, are sitting on the sidelines. Caja Madrid and Barcelona-based La Caixa both have a nationwide presence and are among Spain's top five financial houses. With billions of retail deposits to help them weather the downturn, they have little interest in taking over weaker rivals. Says John Raymond, senior analyst at research firm CreditSights: "They're big enough to ride out any problems." |BW|

–With Charles Penty in Madrid

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Cordray denies he has plans to run for higher office

A Choir Boy Battles Wall Street

Richard Cordray may not look the part, but the Ohio attorney general has assumed the pit bull role once played by Eliot Spitzer and Rudy Giuliani

By Jessica Silver-Greenberg

Richard Cordray lives in a 130-year-old brick farmhouse near Grove City, Ohio, just four miles from the modest home where he polished his jump shot growing up. He played varsity basketball for the local high school and was valedictorian. In 1987, Cordray won $45,303 on the game show *Jeopardy!*, retiring as a rare five-time champion. Now, Cordray, 50, is his home state's attorney general. His ethics appear above reproach. When the *Dayton Daily News* endorsed him for attorney general in 2008 it called him a "choir boy"—a comparison that almost understates the perfection of his résumé. Choir boys sometimes sing off-key.

On Wall Street, Cordray is seen less as too-good-to-be-true than as the heir of pit bull prosecutors-turned-politicians such as Eliot Spitzer and Rudy Giuliani. In the past year, Cordray, a Democrat, has sued Merrill Lynch for allegedly misleading investors and former American International Group executives for alleged accounting fraud—winning settlements of $475 million and $115 million, respectively. He's the lead plaintiff in a multistate suit against Bank of America alleging that the firm withheld bad news from investors just before its 2009 acquisition of Merrill Lynch. More recently, Cordray has taken on bond-rating agencies Standard & Poor's, Moody's Investors Service, and Fitch Ratings, which he says deliberately gave triple-A ratings to junky debt to win fees and retain business. "Some Wall Street corporations seem to act with complete and total disregard for the work of regular Ohioans," says Cordray. "My central goal, and the goal of this office, is to protect those hard-working Ohioans."

Cordray, who was elected attorney general in 2008 following the resignation of fellow Democrat Marc Dann amid a sex scandal, says he's not planning to run for governor in 2014. Others predict he will. "I think it's quite likely," says John C. Green, professor of political science at the University of Akron. "Building a record while in office is good politics in any event—it can help him this year and in future elections." John Fortney, a local television news anchor who has covered Ohio politics for two decades and was a panelist at the 2008 attorney general debate, is certain Cordray will enter the race. "I think you will find him making a run for governor just because the party needs him."

As attorney general, Cordray has chosen his cases with the care of someone intent on burnishing a political résumé. "He files these suits more for politics than for good policy," says Mark R. Weaver, who from 1995 to 1999 served as deputy attorney general under Republican Betty Montgomery and now works as a political consultant. Cordray says his case selection is apolitical. Shortly after taking office, he says, he threw out a suit against lead-paint manufacturers—an easy political target if ever there were one—because the state's legal arguments were too flimsy.

In suing the rating agencies, Cordray is taking on his biggest challenge yet. The firms may be vilified by people angry about the credit crisis, but they're also tough legal competitors. Over the years the ratings firms have succeeded many times in persuading courts that bond ratings are nothing more than editorial opinions, and thus are subject

MICHAEL NEMETH/WONDERFUL MACHINE

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to free speech protection under the First Amendment of the U.S. Constitution. In 1997, Orange County, Calif., lost a suit against Standard & Poor's on these grounds.

After the financial crisis, though, the First Amendment defense looks less solid. In September 2009, Judge Shira A. Scheindlin of the U.S. District Court in New York denied a motion from Moody's and S&P to dismiss a suit brought by Abu Dhabi Commercial Bank and King County, Wash., on First Amendment grounds. "The crux of the cases will be whether there was a known misrepresentation," says Spitzer, the former New York governor and, before that, attorney general, who is a Cordray admirer. "Being wrong is not a crime." Kevin M. LaCroix, an attorney and partner at OakBridge Insurance Services, says of the suit's chances: "I think it's an uphill but not insurmountable battle." Moody's and S&P say the suit is without merit. Fitch didn't return phone calls seeking comment.

Cordray, a corporate lawyer for two decades who has argued seven cases before the U.S. Supreme Court, is bringing in top-flight private litigators for the fight. Whereas Spitzer famously assigned the bulk of his office's legal work to in-house attorneys, Cordray is recruiting from big outside firms such as Entwistle & Cappucci, Lieff Cabraser Heimann & Bernstein, and Schottenstein Zox & Dunn. Critics say the practice wastes taxpayer money, since the outside attorneys will reap big contingency fees from any settlement. "Even if the cases are successful and Ohio recoups some money, a large portion is lost to paying well-connected plaintiffs' firms," says Weaver. In February members of the state's Controlling Board, a group charged with overseeing fiscal issues, demanded that Cordray's office justify the additional cost to the state. The board asked why the attorney general's office would pay attorneys from Hogan & Hartson $670 an hour in a case involving the University of Cincinnati's University Hospital when in-house lawyers command far less. Cordray says the cases are assigned on merit, and that the university is paying Hogan & Hartson's high-priced bill. Before pursuing the Bank of America suit, for example, he convened a group of lawyers in his Columbus office to debate whether to litigate and make a pitch for why their firms should win the state's business. "He peppered us all with very detailed questions," says Max W. Berger, whose firm, Bernstein Litowitz Berger & Grossman, has contracted with Cordray's office on the case. Bank of America declined to comment on the case.

While Cordray says he's eager to take on BofA and the ratings agencies, he doesn't want a protracted court fight. He isn't unique among attorneys general, who have historically fought corporate foes in public forums and settled before going to trial. Class-action attorneys say attorneys general revel in the publicity of big settlements—and hope to avoid alienating the public with costly court battles. "They believe in trial by press conference," says Boris Feldman, a partner with Wilson Sonsini Goodrich & Rosati, a securities-litigation specialist in Palo Alto, Calif. "It's very rare that they actually litigate a case." Perhaps that's because the few who have ventured into court haven't always fared well. In 2004, then Attorney General Spitzer sued Richard A. Grasso, the chairman of the New York Stock Exchange, for allegedly misleading investors about his pay package. While Spitzer won in New York State Supreme Court, the decision was largely overturned by the New York State Court of Appeals.

If Cordray beats the odds and wins a splashy settlement with the ratings agencies, it would certainly bolster his chances of winning the governor's race in 2014. That's if he decides to run, of course. For now, Cordray says he intends to focus on his job as Ohio's top prosecutor. "The key is to do a good job now." A good job for Ohioans might not win him many friends on Wall Street. |BW|



SHANNON STAPLETON/REUTERS

Cordray is suing BofA for allegedly misleading investors

CORDRAY'S USE OF EXPENSIVE OUTSIDE ATTORNEYS HAS DRAWN SCRUTINY FROM OHIO'S FISCAL WATCHDOGS

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Mehri is a "master of creating publicity"

Is Madison Avenue Too White?

After settlements with Coke and Texaco, Cyrus Mehri is pushing for racial diversity in the ad industry

By Burt Helm

The U.S. advertising industry, long adept at shaping the image of clients, soon may have to defend and burnish its own reputation.

Cyrus Mehri, a plaintiffs' attorney with a penchant for embarrassing powerful opponents, says he has filed racial discrimination charges with the Equal Employment Opportunity Commission against the Big Four advertising companies—Interpublic, Omnicom, Publicis, and WPP. The move could lead to a class action. "There's been a call for help by African Americans in this industry," Mehri says. "After decades of stonewalling, it's time to create a new day on Madison Avenue." Interpublic says it has diversity programs, is making progress, and hopes to continue a dialogue with Mehri. Omnicom declined to comment, and Publicis and WPP did not return calls.

The ad industry can expect a nasty fight. Over the years, Mehri, 48, has extracted hundreds of millions of dollars from companies, including Texaco and Coca-Cola, to settle similar allegations. "Cyrus is a master of creating publicity," says Hunter Hughes, who mediated the Coke settlement in 2000.

A son of Iranian immigrants, Mehri says he was drawn to advocacy early. His mother, he says, fled to the U.S. after denouncing the Shah of Iran. His great-grandfather, a cleric, got in trouble with Iran's religious Establishment for defending the Baha'i minority. Before getting a law degree from Cornell University, Mehri worked with Ralph Nader. "Trying to make things better is part of my lineage," says Mehri, who says that 20% to 28% of any settlement typically goes to him and other lawyers.

Mehri made his name in 1996 with the Texaco racial discrimination case. While his colleagues argued the case before the judge, he focused much of his energy on the court of public opinion. His coup de grace: announcing he had audio tapes of Texaco executives allegedly using racial slurs and talking about destroying evidence. The company denied its executives used racial epithets and settled for $176 million.

During the suit against Coke, Mehri hatched a plan to bus disgruntled Coke employees to a shareholder meeting and told the media he had evidence that the soda maker had shredded documents (an allegation Coke denied). The company settled for $192.5 million. More recently, Mehri set his sights on gender discrimination on Wall Street, settling with Morgan Stanley in 2007 for $46 million and a year later with Smith Barney for $33 million. Texaco, Coke, and the Wall Street firms all set up outside diversity monitors as well. "He's better at sound bites than almost any lawyer I know," says R. Lawrence Ashe Jr., who fought Mehri in the Coke case and a more recent racial discrimination suit against Johnson & Johnson that never got off the ground.

The outlines of Mehri's latest campaign are emerging. Last year he persuaded the National Association for the Advancement of Colored People to ask 25 major U.S. advertisers to order their agencies to create more diversity in the ranks. Since then, says NAACP General Counsel Angela Ciccolo, 14 have agreed to cooperate with her organization. GlaxoSmithKline, PepsiCo, Procter & Gamble, Toyota Motor, and Unilever all say they have encouraged their agencies to include more nonwhites on assignments.

What happens next? The EEOC will look for evidence that ad agencies discriminate. Mehri can still sue even if the commission decides otherwise, though his case would suffer a loss of legitimacy. As he assembles his legal strategy, he plans to crank up public pressure. In the next two months, he and the NAACP say they will hold a "summit" where they'll discuss the ways agencies discriminated against employees. It's classic Cyrus Mehri. |BW|

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PLEASE HOLD FOR MISTER BUFFETT

WHAT'S IT LIKE TO HAVE AMERICA'S GREATEST INVESTOR AS YOUR SHAREHOLDER? WARREN BUFFETT'S BIOGRAPHER TALKS TO CEOs WHO KNOW. BUFFETT'S ADVICE IS PRICELESS, OF COURSE. JUST DON'T MAKE A DEAL HE DOESN'T LIKE

By Alice Schroeder

Photograph by Dennis Van Tine

Who wouldn't love to pick up the phone and ask Warren Buffett for advice? People have spent more than $1 million just to have lunch with the man. He was voted the most admired corporate director in America by *Directorship* magazine in 2008. Chief executives of companies he has a stake in laud his patience, foresight, and ability to capture the essence of a complex financial situation in just a few words. They also like the fact that he usually leaves them alone as long as they're getting the job done. ¶ Sometimes Buffett emerges from behind his desk and shows a side of himself that's far less familiar. When he sees something he doesn't like in a company whose shares he owns, the famously passive investor can swing into action to protect his investment—jawboning behind the scenes, scolding, cutting opportunistic deals, even hiring and firing CEOs. For some of those on the receiving end of his activism, it can feel a bit like being attacked by Santa Claus. ¶ Buffett's virtues and philosophy are well known, and at 79, his ability to spread them throughout

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The famously passive investor will swing into action to protect his holdings

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the business world has never been greater. In mid-February, his holding company, Berkshire Hathaway, was listed for the first time on the Standard & Poor's 500-stock index, and the stock price and volume jumped as investors rushed in. His annual letter to shareholders, to be released on Feb. 27, is always one of the most parsed memos of the year. Berkshire's purchase of Burlington Northern in November 2009—a self-described all-in bet on America—and its $5 billion stake in Goldman Sachs make Buffett a major stakeholder in the global economic recovery, with tentacles that span from coal to collateralized debt obligations. And his now infamous dressing down of Kraft CEO Irene Rosenfeld over Kraft's purchase of Cadbury proved that behind that Cherry Coke smile, there's still plenty of bite.

In speaking with CEOS for this story, and in writing the 2008 biography *The Snowball* with Buffett's cooperation, I learned a great deal about the way he manages the people he counts on to make money for him and his shareholders. He is, in many cases, just as genial and supportive as his persona would lead you to believe. "First my mother and then I have been able to call and ask his advice on matters affecting the company, large and small," says Donald E. Graham, CEO of Washington Post Co. "His advice has been worth billions to our not-so-large company."

During the credit crunch of March 2008, American Express CEO Kenneth I. Chenault had to ask for help from Buffett at a moment when Berkshire's stake in American Express had lost $8 billion because of credit losses and concerns the company could not borrow to fund its operations. One might think Chenault had reason to fear the call. Instead, he knew Buffett, whose company owns 13% of American Express, would be his "confidence booster." Even in the highly charged atmosphere of a financial meltdown, his style is unwavering—"objective, direct, and he knows what he believes," Chenault says. The CEO felt fortunate that Buffett was indifferent to the market pressure on American Express.



Buffett turned up on CNBC and called Kraft CEO Rosenfeld's agreement with Cadbury a "bad deal" for Kraft shareholders and a "big mistake"

At the time, Chenault faced intense pressure to cut the company's payout to investors, as his peers had done. Buffett "understood the reputational reasons why American Express should not cut the dividend," he says, and backed the decision to maintain it. Since the crisis, Berkshire's investment has recovered $4 billion of its value.

When other CEO friends got into trouble during the downturn, Buffett offered them more than advice. William C. Foote, head of wallboard and gypsum product maker USG, first met the investor before Berkshire backstopped a USG stock offering in 2006, buying a 17% stake in the company. Foote tried to impress his new shareholder by reciting housing statistics from the 1960s to the 1980s—and was shocked when Buffett immediately responded with data from the 1940s and 1950s.

Although USG was struggling through bankruptcy, Buffett treated Foote with the benevolent neglect he generally displays toward managers whose companies are cruising. Foote would call occasionally and traveled to Omaha two or three times a year, spending a couple of hours chatting in Buffett's office before eating a steak at one of his favorite restaurants. He "doesn't offer suggestions as much as answer questions and provide perspective," Foote said.

The USG chief found the advice valuable and enjoyed the feeling that Buffett had enough confidence in him not to meddle. Then the housing market imploded and demand for wallboard collapsed. Buffett leaped into the fray in a way that benefited both Berkshire and USG. Berkshire took $300 million of a $400 million issuance of 10% notes convertible until 2018 at Berkshire's discretion into stock at $11.40 per share. (USG was trading at around $5.66 before the deal and is now at about $13.40, meaning the conversion feature is in the money). The equity sweetener effectively raised the cost of the notes, while limiting the impact on USG's income statement to its $30 million an-

(L TO R) JOHN GRESS/REUTERS; BRIAN SMALE; TIM SHAFFER/REUTERS; BRENDAN HOFFMAN/BLOOMBERG; ERIC MILLETTE



IRENE ROSENFELD
CEO
KRAFT FOODS

KEN CHENAULT
CEO
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nual cash interest tithe to Berkshire, helpful at a time when USG is losing hundreds of millions of dollars a year.

When Buffett is unhappy with a CEO, you can tell mostly from what he doesn't say. "He criticizes by omission and faint praise," says former Wells Fargo Chairman Richard M. "Dick" Kovacevich, a longtime friend and world-class manager whom Buffett has compared to Wal-Mart founder Sam Walton. "If you are a close observer of him, it's not hard to figure out."

To be publicly criticized by Buffett, even subtly, might send a shiver through any executive who does business with him. It happened to Irene Rosenfeld on Jan. 21, after Kraft agreed to buy the iconic British candy company Cadbury for $13.17 a share. Berkshire is Kraft's biggest shareholder, with a 9.4% stake. Buffett had opposed an earlier version of the deal but said if Kraft put up more cash in a revised deal that didn't "destroy value," he would approve.

Kraft's share price rose because the remarks seemed to indicate that a modestly higher bid could meet his terms as long as it contained less stock. When Rosenfeld carried out a version of the plan, agreeing to pay $7.74 in cash and offer 0.1874 new Kraft shares for each share of Cadbury, investors assumed the two had worked out a deal. On the day it was announced, William Ackman of hedge fund Pershing Square Capital Management appeared on CNBC and predicted the investor would support it.

Instead, minutes later, Buffett turned up on CNBC and called Rosenfeld's agreement with Cadbury a "bad deal" for Kraft shareholders and a "big mistake." His televised griping stunned observers because it was so uncharacteristic. "You would think he would have been happy—she did what he wanted," says a major shareholder who asked not to be named because he values his relationship with both CEOs. "He reversed himself."

Buffett made it clear he thought the revised bid "destroys value." He seemed especially irate that Kraft had sold its profitable frozen pizza business to Nestlé to raise cash for the Cadbury acquisition (and take its rival out of the bidding for the confectioner). He described the sale price of the pizza business as a cheap nine times earnings (a good deal for a unit that reported significant margin and sales growth during the recession). To avoid a $1 billion tax bill, he argued that Rosenfeld should have spun the unit off tax-free instead. Buffett also seemed to covet the business himself, saying, "I wish I would have bought the pizza business at nine times pretax earnings."

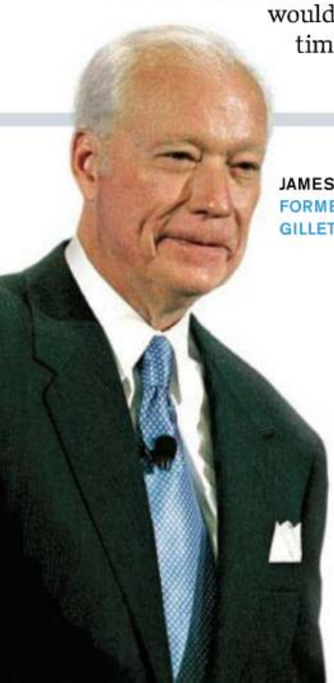
Kraft Senior Vice-President Perry Yeatman says the company respects Buffett and expects him to see the wisdom of the deal someday. Other defenders of Rosenfeld say Buffett's TV appearance was mainly to distance himself from the deal because he didn't get his way. Asked twice by CNBC whether he would sell his Kraft stock, he ducked the question.

Buffett, who did not respond to questions for this article, denied there is a personal rift between him and Rosenfeld; he told CNBC that he likes Rosenfeld, considers her straightforward, and would even have her as a trustee of his will. James M. Kilts, who ran Kraft when it was part of Philip Morris and was CEO of Nabisco before serving as chief of Gillette from 2001 to 2005, is a longtime friend of both. Kilts had no comment on the supposed rift but noted that with Buffett, "It's always business. It's never personal." Buffett's own summation, too, was financial, and he expressed his disappointment in the simplest terms. "I feel poorer," he said.

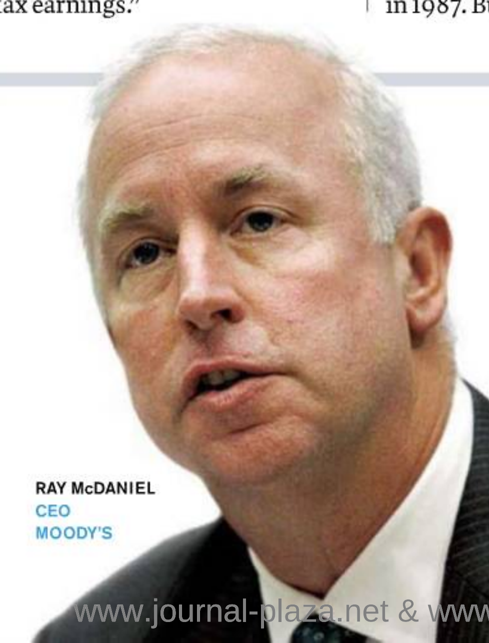
A FRIEND IN NEED

Buffett's vocal treatment of Kraft is poles apart from his handling of most companies in which Berkshire invests. Usually he is warm, helpful, and waits to be asked for his opinion. Despite receiving $600 million from the Troubled Asset Relief Program, M&T Bank, another Berkshire investment, remained relatively stable during the credit crisis. Instead of leaning heavily on Buffett, CEO Robert G. Wilmers spent much of his time the past two years sitting in Buffalo and scooping up other distressed banks. Buffett has always had kind things to say about M&T, partly because Wilmers makes sound acquisitions. He mostly talks with Buffett on the phone. "Eighty or 90% of the time it's on my nickel," he says. He thinks of the investor as a "priceless" sounding board who gives superb advice. In one memorable instance, Wilmers turned to him while being pressured by regulators and investment bankers to participate in the first Chrysler bailout in 1979. Buffett's pithy advice: "Those who won't fill your pocket will fill your ears."

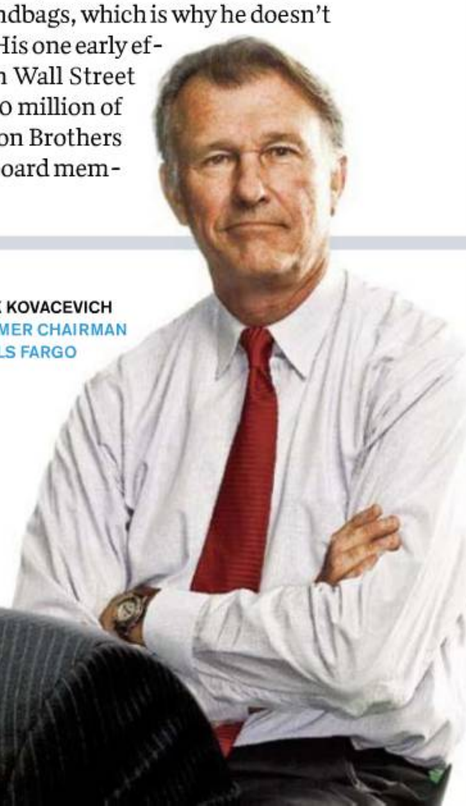
This is how Buffett has typically viewed investment bankers: as useless, self-serving windbags, which is why he doesn't waste time befriending them. His one early effort to profit from investing in Wall Street came to tears when he put $700 million of Berkshire's money into Salomon Brothers in 1987. Buffett was a passive board mem-



JAMES KILTS
FORMER CEO
GILLETTE



RAY McDANIEL
CEO
MOODY'S



DICK KOVACEVICH
FORMER CHAIRMAN
WELLS FARGO

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ber until he had to personally rescue Salomon after one of its traders defrauded the government in treasury bond auctions and the firm nearly failed. Then he waged a bitter fight over severance with ousted Salomon boss John Gutfreund. Managing an investment bank that was teetering on the brink of bankruptcy for nine months was a miserable experience. Buffett later said an important lesson from Salomon was that he had mistakenly trusted the bank's management.

Given that history, investors were shocked when Buffett poured $5 billion of Berkshire's money into Goldman during the depths of the financial crisis. Goldman is the one firm that Buffett has traded with throughout his career, ever since Goldman banker Byron Trott, who has since left the firm, won his trust around 2002 by finding companies for Berkshire to buy.

As a 10-year-old in 1940, Buffett once told me, he met Goldman senior partner Sidney J. Weinberg during a tour of the New York Stock Exchange. ("What stock do you like, Warren?" Weinberg asked him.) Until the financial crisis, though, Buffett had never shaken hands with Goldman CEO Lloyd C. Blankfein. Days after the collapse of Lehman Brothers, when it appeared that all major U.S. banks could fail, it was Trott who approached the investor on Goldman's behalf with a deal richer than that offered by any other company. Berkshire paid $5 billion for 10% perpetual preferred shares of Goldman with attached warrants at $115 at a time when the stock was trading at $125 per share, meaning the warrants were already "in the money." If Berkshire had exercised them immediately, it would have netted $10 per share. Buffett's reputation helped Goldman raise another $5 billion of capital, twice as much as it originally sought.

A few days after, Buffett and Blankfein met for the first time and shared a jovial moment at a conference. Buffett later took steps to protect his investment, first by using his personal capital as America's most trusted investor to publicly defend the federal bailout of Wall Street, then—after Goldman fueled public anger by setting aside billions for employee bonuses—by teaming with its management to put up $500 million to assist small businesses.

Buffett, an outspoken critic of CEO greed, pays himself $100,000 a year. He has nearly all the managers of Berkshire's wholly owned businesses set their own pay, and in light of his tiny compensation, they usually err on the low side, too. When it comes to the companies in which Berkshire invests, though, he takes a broader view. Wells Fargo's Kovacevich reaped tens of million from stock options but opposed reporting them as company expenses. Buffett was a vocal advocate of expensing them, but that didn't hurt their relationship in the least.

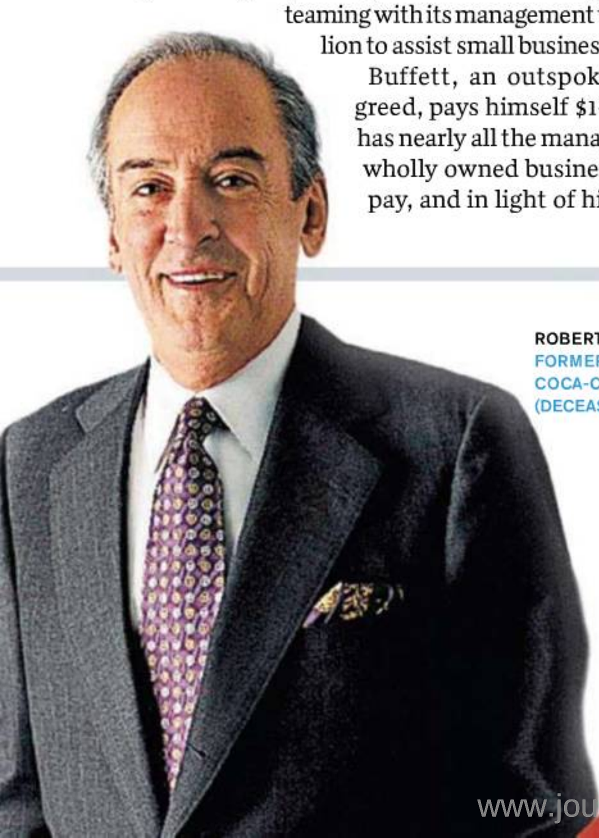
On the same day that Buffett pummeled Rosenfeld on CNBC, he praised Blankfein to Bloomberg News. "I don't think anybody could have done a better job at Goldman Sachs than Lloyd Blankfein," he said. "I give him enormous credit for how he's run Goldman. You've got to expect vilification of banks." Rosenfeld made Buffett feel poorer. Blankfein is making him noticeably richer.

THE ULTIMATE COMPLIMENT

Buffett is fascinated with executives who display unusual mastery at operating a profitable business. He appreciates the nuances of the craft the way an art patron enjoys watching a sculptor at work. Wells Fargo's Kovacevich is one of his favorite CEO artisans, yet Kovacevich calls Buffett "more hands-off than any investor." He says the two have had, at most, 20 conversations in 10 years, even though the bank is one of Berkshire's most important investments. Kovacevich was CEO of Norwest bank when it acquired Wells Fargo in 1998, and at the time Buffett insisted that Kovacevich not tell him anything that would make him an insider, because that would preclude Berkshire from buying or selling the stock.

When Buffett met Jim Kilts in 2001, he told *Fortune* that Kilts—who had turned around Nabisco—"made as much sense in terms of talking about business in general as anybody I've ever talked to." Kilts came out of retirement that year to rescue Gillette, doing so partly because he wanted to work with Buffett, since Berkshire owned 9% of the company. The Omaha investor's fondness for him grew rapidly as Gillette's performance rebounded.

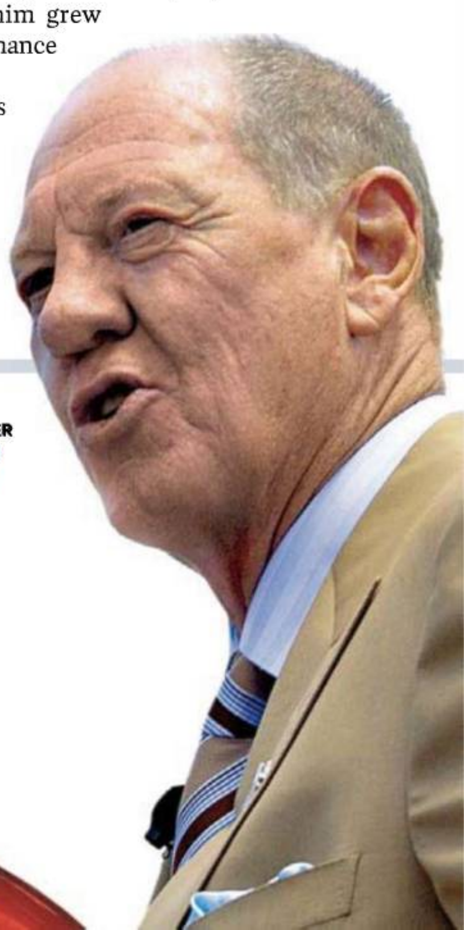
At the time, Gillette was suffering from the multibillion-dollar blunder of overpaying for battery maker Duracell. It had also promised investors unrealistic 15% to 20%



ROBERT GOIZUETA
FORMER CEO
COCA-COLA
(DECEASED)



DOUG IVESTER
FORMER CEO
COCA-COLA



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annual earnings growth, and was channel-stuffing product to its distributors to meet projections. To Buffett's applause, Kilts dropped the practice of issuing earnings guidance entirely. He cut thousands of jobs, closed plants, paid off debt, and shifted resources into new products and advertising.

Even so, Kilts says he tried not to bother Buffett. "It would be so easy to misuse the fact that he was available," Kilts says, "because he would be obligated to talk to me if I picked up the phone." Buffett, he says, was a quiescent board member, but when he did speak "he had such power and weight and clarity that it was memorable." At one board meeting, Kilts proposed increasing directors' pay. Two other directors spoke passionately against the move. Buffett quickly shut down the discussion while saving face for the dissenters by saying, "Well, I'll just take your increase, then."

After the Gillette turnaround, Buffett paid what Kilts considered the ultimate compliment by withdrawing entirely; he resigned from the board. "If you've got the right person running the business," he said at the time, "you don't need me."



"If you've got the right person running the business, you don't need me," Buffett said, paying [then-Gillette CEO] Jim Kilts a compliment by resigning from his board

WHEN WARREN STANDS BACK

Few companies need Buffett more than Moody's, the troubled credit-rating agency. Moody's and its peers have been blamed as enablers of the financial crisis because they inflated the credit ratings of dubious mortgage-backed securities. In March 2009, Berkshire owned more than 20% of Moody's. Why, several former ratings analysts ask, didn't the investor light a fire under the board to tighten the company's standards, or speak out? Surely he was as obliged to denounce flawed ratings that endangered the global financial system as he was to offer an opinion of how much Kraft paid for Cadbury.

A former Moody's employee with intimate knowledge of the executive suite there describes Buffett as "not a very engaged investor." (Like most Moody's sources, he asked not to be identified in light of ongoing investigations into the company.) Another insider confirms that senior management of Moody's, including CEO Raymond W. McDaniel Jr., "doesn't have regular conversations with" Buffett nor does it "seek advice from him on corporate governance or business strategy." Moody's declined to comment.

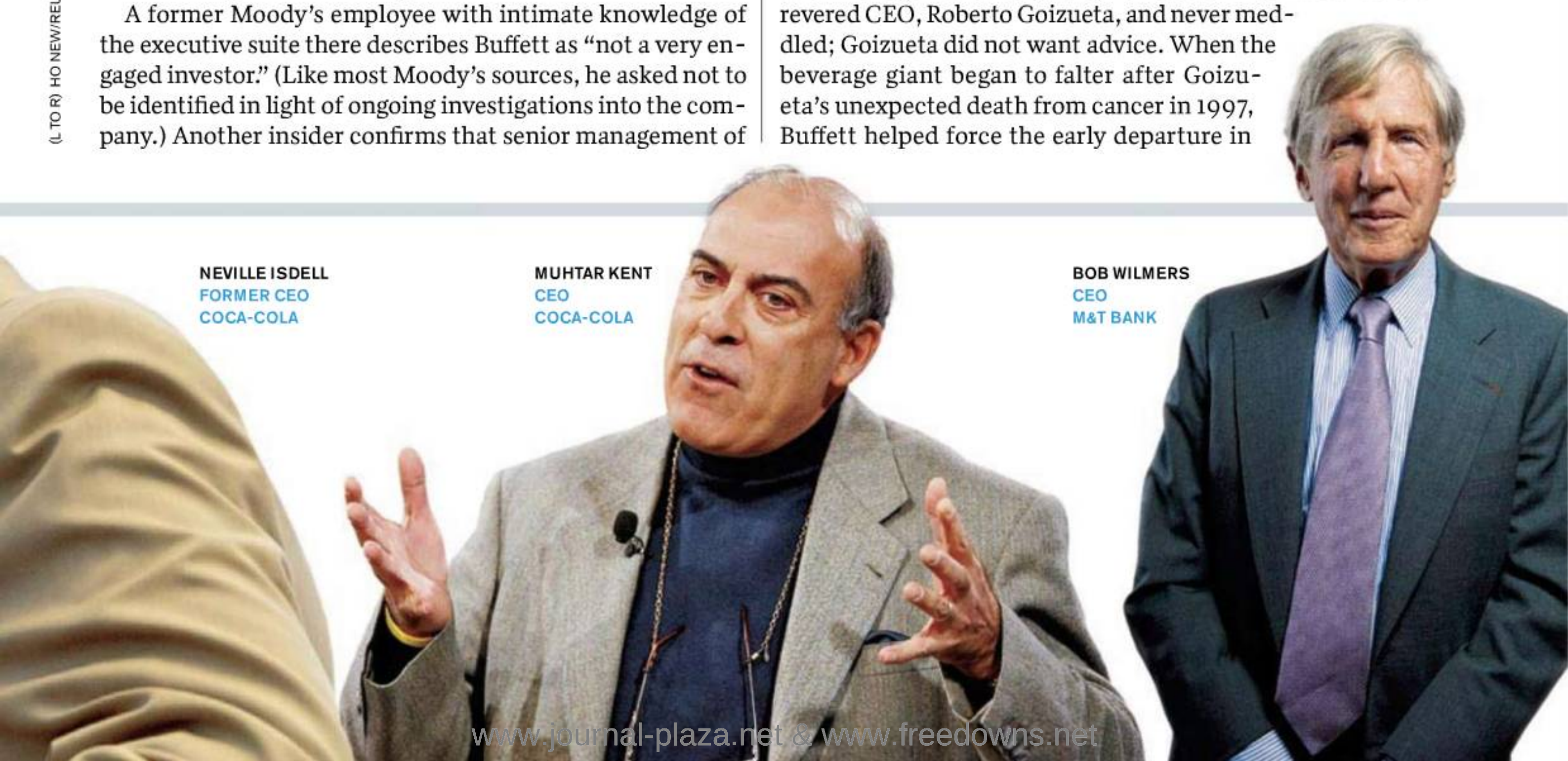
Moody's and Buffett had reason to keep their distance; it's a conflict of interest for the agency to rate a major investor such as Berkshire. Analysts who review a company are supposed to be free of thoughts of what a downgrade might mean to their personal net worth. Moody's discloses the Berkshire conflict in a Securities & Exchange Commission filing.

Even so, one former Moody's analyst describes e-mailing Buffett in 2007 to warn that rating securitized products was a ticking time bomb, and to ask whether he wanted more information. His e-mailed response, says this analyst, said he was a passive investor with a hands-off approach to Moody's. Buffett didn't respond to requests for comment about the e-mail.

It is impossible to quantify the cost of Buffett's disengagement from the rating agency under these unusual circumstances. Moody's stock has since declined more than 50% and investors in asset-backed securities have lost billions. The agency downgraded Berkshire's top AAA rating by one notch in April 2009; Buffett began to sell in July 2009 and has since disposed of about one-third of Berkshire's holdings.

FORCING AN OUSTER

If Moody's is an illustration of what it means to have Buffett's money but not his engagement, Coca-Cola is a portrait of the investor exploring virtually every kind of relationship with management. For years, Buffett admired Coca-Cola's revered CEO, Roberto Goizueta, and never meddled; Goizueta did not want advice. When the beverage giant began to falter after Goizueta's unexpected death from cancer in 1997, Buffett helped force the early departure in



NEVILLE ISDELL
FORMER CEO
COCA-COLA

MUHTAR KENT
CEO
COCA-COLA

BOB WILMERS
CEO
M&T BANK

(L TO R) HO NEW/REUTERS; ANN STATES; DAVID WALTER BANKS/BLOOMBERG NEWS; MICHAEL BUHOLZER/REUTERS; RHEA ANNA

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1998 of Goizueta's successor, M. Douglas Ivester. That year, Coca-Cola stock was at a peak and Berkshire's stake was worth $17 billion. For the next few years, the company meandered further off course, and as it did, Buffett became increasingly involved in trying to set things right. In 2000, Ivester's successor, Douglas N. Daft, proposed buying Quaker Oats for its Gatorade brand. Buffett quashed the idea at a special board meeting, using a trademark one-liner: "We would have given up 2 billion cases a year of Coca-Cola to get something like 400 million cases a year of Gatorade." PepsiCo subsequently bought Quaker Oats in a deal that is widely regarded as successful, and the wisdom of Coca-Cola in passing up the opportunity has been debated far and wide. What is not debated is Buffett's influence.

Buffett became deeply disturbed by Coca-Cola's chaotic culture and poor earnings, but few people knew how upset he was because he said little in public. Daft retired in February 2003, citing health reasons. Buffett became directly involved in the CEO search. He tried to charm Kilts into taking the job. When Kilts said no, he tried to recruit former General Electric CEO Jack Welch. Eventually, Buffett signed off on bringing former Coca-Cola executive E. Neville Isdell out of retirement to stabilize the company. When Isdell retired, he was succeeded by Muhtar Kent, who has offset declines in domestic sales with growth in emerging markets. As Coke's fortunes improved, Buffett's relationship with its CEOs grew more cordial. He withdrew from his activist role, resigning from the board in 2006. Berkshire still owns 200 million shares and 8.6% of Coca-Cola, a stake now worth $11 billion.

BETTING ON A "CHOO-CHOO"

In April 2008, Buffett took a hamburger- and jellybean-fueled trip on a vintage railcar from Kansas City, Mo., to Chicago with Matthew K. Rose, CEO of Burlington Northern Santa Fe. They used the 430-mile journey to talk over Rose's plans to move the railroad's recent turnaround into high gear. Rose showed his guest Burlington's Chicago intermodal freight yard, which handles containers that move among ships, trains, and trucks without being unloaded. Buffett eventually increased Berkshire's ownership of Burlington to 22%.

In 2009, Rose agreed to sell the rest of the railroad to Berkshire for $26 billion, giving Buffett what he calls his "choo-choo." Buffett described this as an "all-in wager on the economic future of the U.S." He's betting that rail traffic will grow, and imports from Asia will continue to dominate as the economy mends. Burlington is the nation's biggest coal hauler—coal transport represents more than a fifth of its revenues—so he's assuming the world will keep using coal even if the U.S. switches to cleaner energy sources. Lastly, Burlington could be a big winner if railroad rights-of-way become power corridors to conduct energy from wind farms.

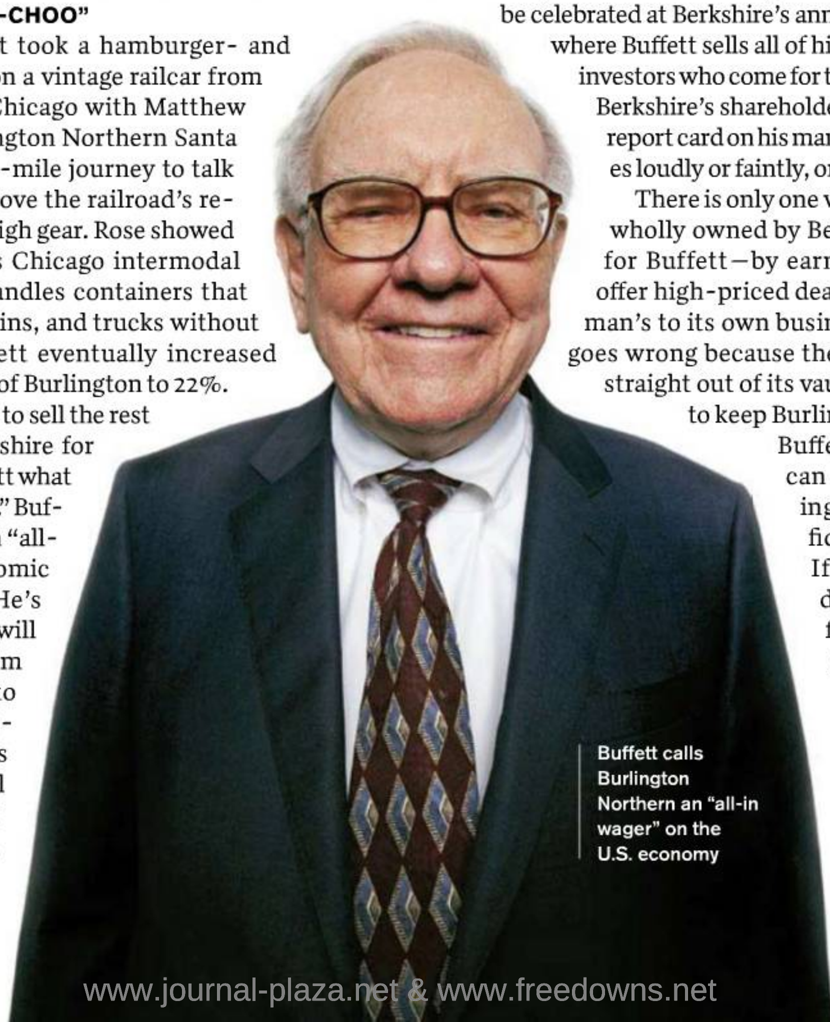
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Buffett always likes a sweetener, and Burlington gives him one in the form of information. He learns about wallboard demand from USG and consumer-credit trends from American Express, but Rose has called the railroad a kaleidoscope of the economy. Rail traffic patterns are a window on commodity, wholesale, consumer, and international trade flows. Buffett is adding this kaleidoscope to what his other CEOs tell him about the "reset of the consumer" to a lower level of spending. They feed him data from Berkshire's portfolio of companies—sales of building materials, jewelry, furniture, real estate, credit, fractional jets, vacuum cleaners, fabricated steel, newspaper ad lineage, and other products and services. He may now command as much information about the state of the U.S. economy as anyone, including the Federal Reserve—and probably gets his faster.

This should go a long way toward maintaining Rose's relationship with his new boss. What else can he expect now that he works for Buffett? He can call whenever he wants and get the best advice in corporate America, and Buffett will put on events to boost his employees' morale. In return, Rose, who declined comment, needs to make money for Buffett. If he does, he will be celebrated at Berkshire's annual meeting in Omaha—where Buffett sells all of his products to the 35,000 investors who come for the show—and cheered in Berkshire's shareholder letter, Buffett's annual report card on his managers, in which he praises loudly or faintly, or punishes with silence.

There is only one way for a company that's wholly owned by Berkshire to make money for Buffett—by earning it. Berkshire can't offer high-priced deals like USG's and Goldman's to its own businesses when something goes wrong because the proceeds would come straight out of its vault. So Rose's No. 1 job is to keep Burlington out of trouble.

Buffett is betting that Rose can do it. He bought Burlington partly out of confidence in the executive. If all goes right, their dealings will be long, friendly, and mutually profitable. As former Gillette CEO Kilts says, "We had a warm, close, personal relationship, but at the end of the day, I knew it was business." |BW|



Buffett calls Burlington Northern an "all-in wager" on the U.S. economy

DAVID YELLEN

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WHAT I LEARNED FROM MY DAD

When his youngest son decided to become a musician, Buffett offered moral but not financial support

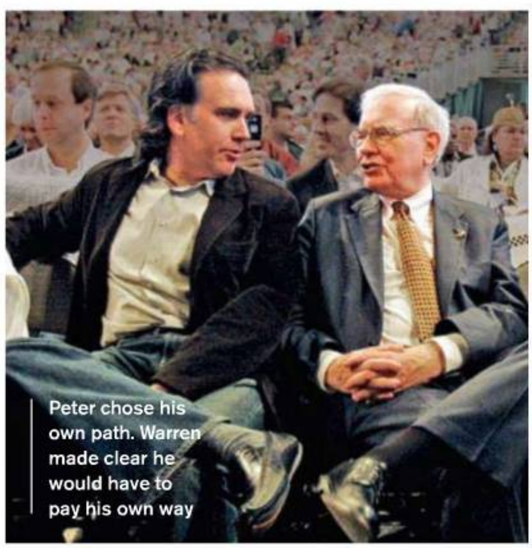
By Peter Buffett

One of my father's often-quoted tenets is that a parent, if he has the means to do so, should give his children "enough to do anything, but not enough to do nothing." A head start is fine; a free pass is often a crippling disservice. When I turned 19, I received my inheritance—proceeds from the sale of a farm, which my father converted into Berkshire Hathaway stock. At the time I received them, the shares were worth roughly $90,000. It was understood that I should expect nothing more.

So—what to do with the money? I was a student at Stanford University; there were no strings attached. Fortunately, I'd had the advantage of seeing my older siblings burn through most of their cash; I didn't want to follow down that path. At the other extreme, I might have done absolutely nothing with that stock—just left it in an account and forgotten about it. If I'd picked that option, my shares would now be worth around $72 million. But I didn't make that choice, and I don't regret it for a second. People think I'm either lying or crazy when I say this, but it happens to be true, because I used my nest egg to buy something more valuable than money: I used it to buy time.

My inheritance came to me around the time I was finally committing to the pursuit of a career in music. As a pragmatic Midwesterner with a very limited nest egg, I knew that I would have to find a way to turn my creative impulses into a livelihood. But how did one do that? How would I find an audience, or clients, or a way to sell what I'd written and produced? I didn't have a clue, but it was becoming clear to me that I wasn't going to figure it out by staying in a university.

I decided to leave Stanford and use my inheritance to buy the time it would take to figure out if I could make a go of it in music.


Peter chose his own path. Warren made clear he would have to pay his own way

With help from my father, I worked out a budget that would allow me to conserve my capital as long as possible. I moved to San Francisco, where I lived very frugally—small apartment, funky car. My sole extravagance was in expanding my recording equipment. I played the piano, wrote tunes, experimented with electronic sounds. Then I put a classified ad in the *San Francisco Chronicle*, offering to record all comers in my studio.

And I waited until a very important bit of good luck tracked me down one day in 1981, as I stood at a San Francisco curbside washing my crummy old car. A neighbor with whom I'd had nothing more than a nodding acquaintance happened by and asked what I did for a living. When I told him I was a struggling composer, he suggested I get in touch with his son-in-law, an animator who was always in need of music. I followed up, and the son-in-law did have work for me. He'd been commissioned to create 10-second "intersticials"—quick ads meant to flash a logo and establish a brand ID for a newly conceived cable channel.

I took the work. And the cable channel more than launched; it rocketed to the moon. It was called MTV. Soon many TV outlets wanted to look and sound like MTV. I no longer had to take on unpaid work.

My inheritance was relatively modest, but it was more than most young people receive to get a start in life. Having that money was a privilege, a gift I had not earned. If I'd faced the necessity of making a living from day one, I would not have been able to follow the path I chose.

Would my father have helped me get started if I'd chosen a career on Wall Street? I'm sure he would have. Would he have given me a job at Berkshire Hathaway if I'd asked for one? I suppose so. But in either of those cases, the onus would have been on me to demonstrate that I felt a true vocation for those fields, rather than simply taking the course of least resistance. My father would not have served as an enabler of my taking the easy way out. That would not have been an exercise of privilege, but of diminishment. |BW|

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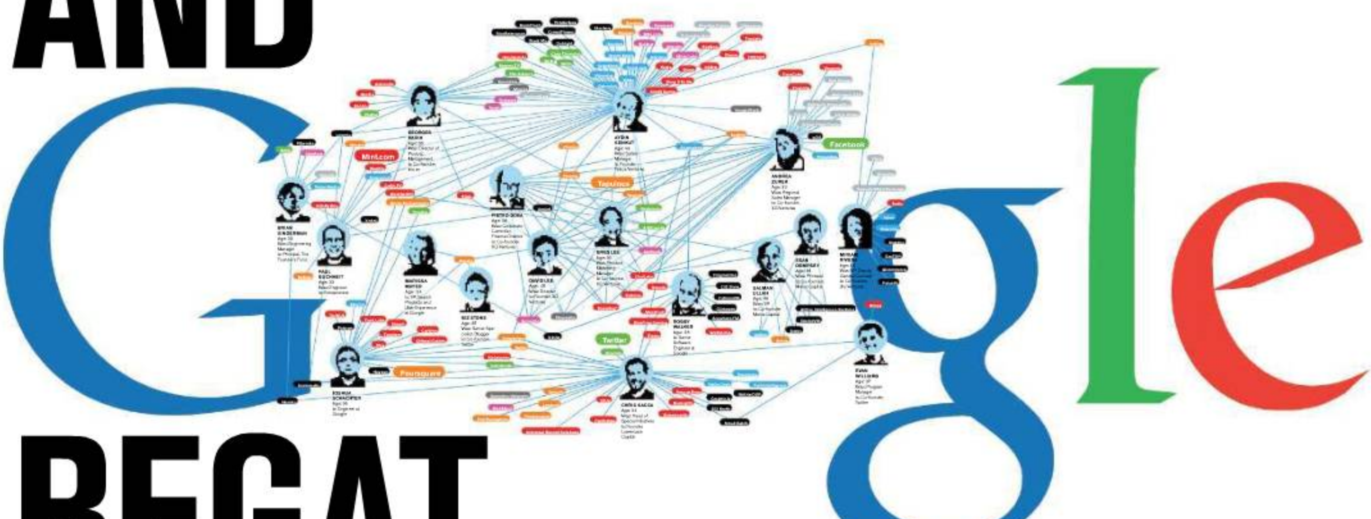
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AND Ggle BEGAT...

THE SEARCH GIANT'S FORMER EMPLOYEES ARE SEEDING TECH STARTUPS— AND SHAPING ANOTHER WAVE OF INNOVATION

By Spencer E. Ante and Kimberly Weisul

Infographic by Ronald Plyman/BW

During the holidays last year, Aydin Senkut and Elad Gil gathered 50 of their friends at a health-food restaurant in Palo Alto. Over turkey burgers and tofu wraps, they talked about tech trends and how to get rich. Or, more precisely, how to get richer.

Senkut, Gil, and their dining circle are alumni of Google, one of the greatest engines of wealth creation the U.S. has ever known. Since going public six years ago, Google has generated more than $170 billion for its employees and investors. Many of the millionaires the company has produced are young, wired into the latest developments in tech, and at ease with risk. Which explains why so many Google alums—including many of those at Senkut and Gil's gatherings—are active angel investors, attempting to add another zero to their bank accounts and another innovative company to their list of accomplishments. "I feel like we have such a strong network, it's almost like we've recreated Google outside of the Google walls," says Andrea Zurek, a 39-year-old backer of 26 startups.

More than 40 ex-Googlers have invested in about 200 fledgling companies since 2005, according to the research firm YouNoodle and reporting by *Bloomberg BusinessWeek* (see graphic, page 40). At least a half dozen current Google executives, including CEO Eric Schmidt and co-founders Larry Page and Sergey Brin, are also financing young companies. Numerous angel-watchers say the Google group has more in common than just pedigree. Unlike many venture capitalists, the Googlers like to swap investment ideas and back startups together. They're also willing to take big chances. "[They're getting into] very risky deals that can be extremely rewarding," says Jeff Clavier, a veteran venture capitalist who founded Palo Alto-based SoftTech VC in 2004. "They have been very active as a group over the past two to three years."

MORE THAN MONEY

The results have been impressive. Companies backed by Googlers include Twitter, Tesla Motors, and gamemaker Tapulous. "As Google matures, its alums are continuing to have a huge impact on Silicon Valley and the tech industry," says Ron Conway, one of the Valley's most active angel investors, who has backed 190 companies, including Google, Facebook, and Twitter.

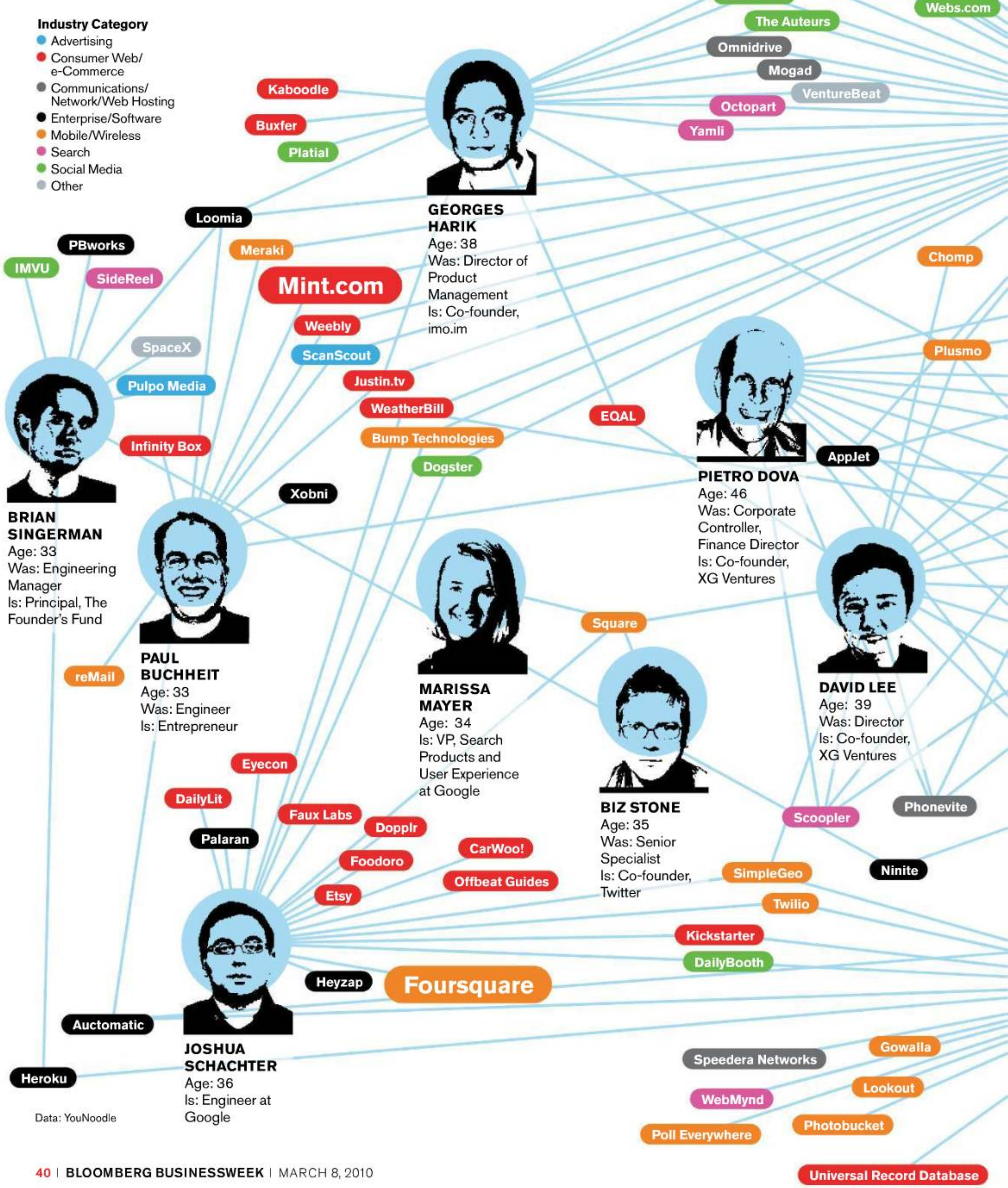
One reason for their success is that Google's angels have more to offer struggling entrepreneurs than just money. Bart Decrem, a Stanford University law grad, turned to the Google network when he was starting Tapulous in 2008. The company's Tap Tap Revenge game requires players to tap on-screen balls to the beat of a song—not exactly a sure thing of an idea. But Decrem thought the game might become a substantial busi-

Story continues on page 42

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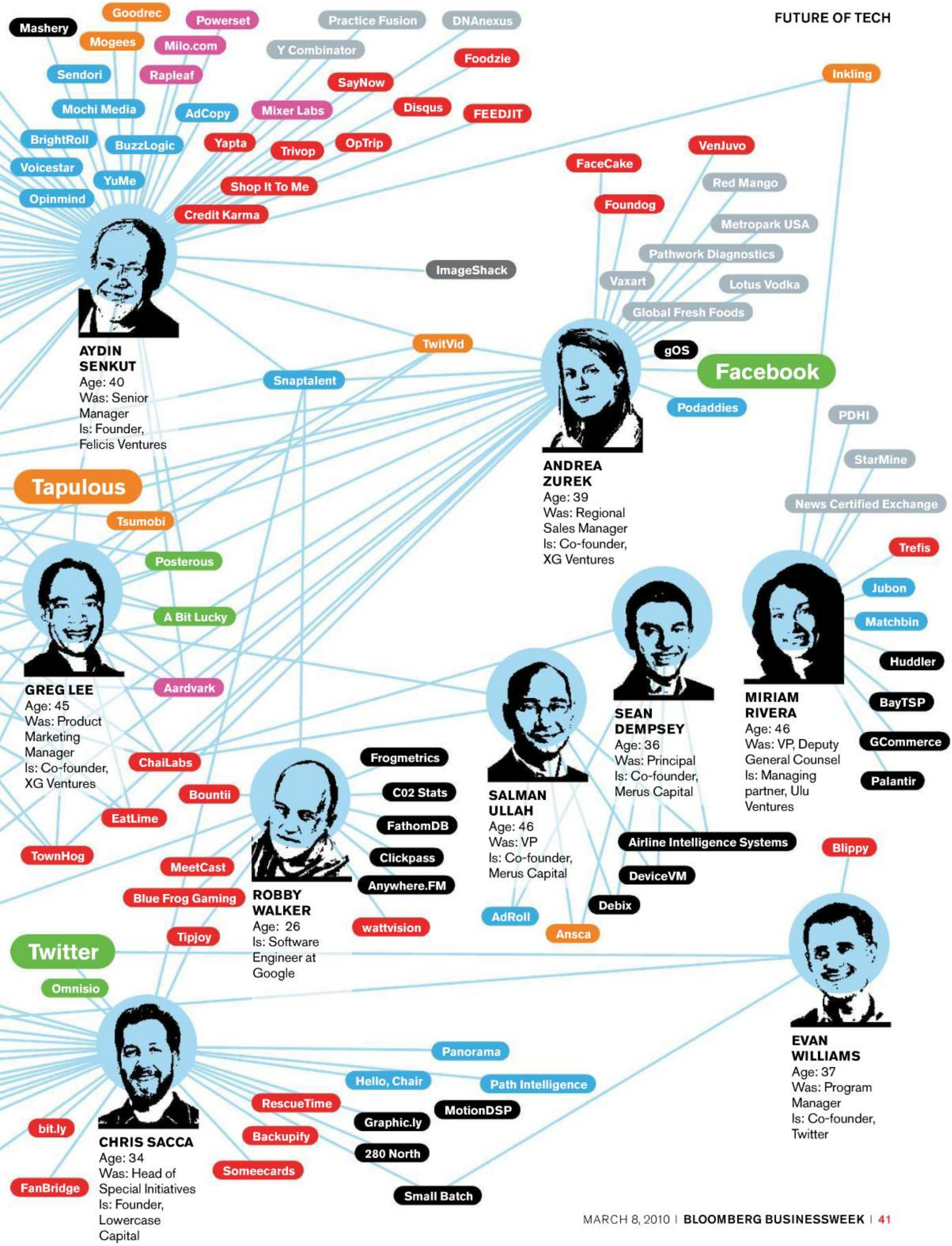
Google's Angels Spread Their Wings

More than 40 ex-Googlers are helping finance a new generation of startups, 200 at last count, according to research from YouNoodle and reporting by *Bloomberg BusinessWeek*. Here's a sample of their deals, along with their past and current jobs:



Data: YouNoodle

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ness by selling it on Apple's iPhone. He raised $500,000 from a dozen angels, including Senkut and Zurek, who advised on strategy, connected the company with new partners in Asia, and helped it explore platforms for mobile phones that use Google's Android software. Today, Tap Tap games have been downloaded more than 25 million times and Tapulous is solidly profitable, with $1 million in revenues a month.

Google's Angels dabble in a wide variety of businesses. Zurek has money in a premium vodka maker and a South Korean frozen yogurt emporium. Yet the angels tend to concentrate their cash in what they know—search technology, mobile computing, and the consumer Internet. Already, Twitter, backed by former Google executive Chris Sacca, is the hottest startup in Silicon Valley, pioneering a new field of real-time communications. The online personal finance service Mint.com, with money from Senkut, proved so popular that market leader Intuit bought it for $170 million last year and made founder Aaron Patzer one of its top execs. Search provider Powerset, backed by Senkut, was acquired by Microsoft in 2008, and its technology became a key part of the Bing search engine.



Tweet success: Chris Sacca's most successful stake has been in Twitter

SERIOUS SCHMOOZING

The most active Google angel thus far is Senkut, a 40-year-old native of Turkey who has invested between $25,000 and $150,000 in more than 60 startups. Senkut joined Google in 1999 as its 63rd employee. He left in 2005 and promptly took his mother to Paris for her 60th birthday, purchased two multimillion-dollar homes in the Bay Area, and treated himself to a Lamborghini.

With that out of his system, he set about becoming a full-time angel. Senkut is often the first investor behind an idea, and to date 11 of the startups he helped fund have been bought by companies including Google, AT&T, and Microsoft. Senkut also fosters the investment of others by organizing two regular events for alums, one for angels and entrepreneurs, and another for all ex-employees, at spots such as the Calafia Café in Palo Alto, owned by Google's first in-house chef. Senkut is raising money for his firm, Felicis Ventures, according to two angel investors, and could not comment on his investments for this story. (Securities laws prevent the public solicitation of funds.) In an interview last October, though, before four of his companies were sold, Senkut said his investments had produced double-digit annualized returns and that, at the time, he was being pitched new business ideas several times a day.

If Senkut is the established star among the Google angels, Chris Sacca is the up-and-comer. The 34-year-old Georgetown University law grad joined Google in 2003 and left in 2007. Of the 31 startups he's backed, his biggest hit is Twitter, in which he invested $50,000 just as it was getting started in 2007.

Working out of a 3,000-square-foot home in Truckee, Calif., a small ski town near Lake Tahoe, Sacca hikes and snowshoes most mornings before breakfast and commutes to San Francisco for three days every two weeks. It's an unconventional way to supervise investments, but Sacca has an unconventional approach to investing, period.

One Friday night in December 2008, he posted a message on Twitter asking if any startups were working late. "We tweeted back, 'we're FanBridge and we work hard every Friday night,'" says Spencer Richardson, its 25-year-old co-founder. FanBridge makes software that helps musicians manage marketing and relationships with their fans. A few weeks later, Sacca flew to New York and met with the company's founders. "They had day jobs and built this site that had 20 million users, adding 100,000 users a day," says Sacca. "It was a no-brainer."

Over the next few months, Sacca invested $50,000 and pulled in several hundred thousand dollars from other angels. Last year, FanBridge's founders considered offering their products to authors, comedians, and other artists; Sacca advised them to stay focused on the music industry. Today, FanBridge is profitable and used by 55 million music fans. "The feedback from him was, 'start by being the best at something, then branch out,'" says Richardson.

The Google Angels may have several more breakout companies developing in their portfolios. Sacca has invested in Lookout, a promising developer of security software for mobile phones. Several ex-Googlers and current Vice-President Marissa Mayer are behind Square, which aims to displace credit-card swiping machines with a cheaper payment system that works through smartphones. And current Google exec Joshua Schachter helped finance Foursquare, a mobile phone service that lets friends share tips on local hotspots and is being used more than a million times a week. "What drives us is the innovation, the excitement of working with people we like," says Zurek.

Paul Graham, who co-founded the startup incubator Y Combinator, believes the tech industry has just begun to appreciate that Google's wealthy ex-employees may have not just a single innovative second act, but potentially hundreds of them. "When people write the history of Silicon Valley 20 years from now," says Graham, "the true impact of Google could come more from all the things that Google people go on to do after they leave Google." **BW**

BUSINESSWEEK.COM | Who are the top angel investors? To find out, go to www.businessweek.com/go/10/angels

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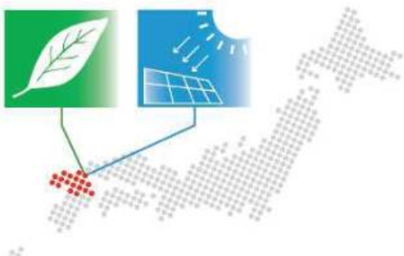
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Success Begins with Innovation

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The Japan Regional Initiative - Eco Island Kyushu: Innovating Hope for Tomorrow



Japan has been on the tip of tongues everywhere as investors look for new international opportunities in anticipation of the expected global economic recovery. With its steady growth and continuous development of innovative new technologies backed by one of the highest R&D investment rates in the world, Japan seems the natural choice. For many however, their investigation of Japan stops at Tokyo, Osaka or Nagoya, when in fact there are numerous untapped possibilities all across the country. One region investors would do well to look into is northern region of Kyushu, the southernmost of Japan's main islands, where the environmental technologies that could shape our lives and futures are being created. With a population of over 5.8 million* and a gross regional product of US$179.5 billion**, northern Kyushu is home to highly developed manufacturing and research clusters in the automotive, silicon, biotech and environmental technology fields. The region also boasts an ideal location for international business, with major ports only a short distance from South Korea and China, international airports providing a 24-hour connection to the rest of Asia, and high speed rail linking the area directly to the heart of Japan, all of which make northern Kyushu a true gateway to Asia. Northern Kyushu is also proud of its track record of international cooperation between private firms, research institutions and government agencies, and welcomes the world to join in new enterprises here.

The Power of Green Thinking

One of the most pressing issues the world faces today is the need for sustainable energy sources that can reliably meet growing global consumption with minimal environmental impact. In the northern Kyushu region, one can find an amazing breadth of research being done in both the public and private sectors to produce viable solutions to this problem. Researchers at the Kyushu Institute of Technology, for example, are working on developing pigments capable of converting solar energy into electricity and advanced semiconductors using titanium oxide. In Saga Prefecture research into improving solar electricity development is in planning and already the area has the highest rate of solar battery usage in Japan. In addition, at the Institute of Ocean Energy at Saga University researchers have developed a new Ocean Thermal Energy Conversion System as well as the world's most efficient method for extracting lithium from seawater. In nearby Miyazaki Prefecture, a large-scale solar electric power plant is scheduled to go online in the near future. Another idea being developed in northern Kyushu is the use of hydrogen energy as a possible replacement for gasoline and other fossil fuels. Kyushu University in Fukuoka is already a focal point for research in this field, attracting academics and corporate partners from around the globe. In 2004, Fukuoka Prefecture began the Hy-Life Project, a joint endeavor between regional academic, industrial and government bodies to stimulate hydrogen R&D, produce real-world applications, educate workers and the general public, and increase awareness and acceptance of hydrogen power through demonstrations that included vehicles, homes and entire towns run completely on hydrogen.

Offering Earth a Better Future

The other side of our need for new energy sources is the need to find ways of reducing our consumption levels and minimizing or even undoing the environmental impact of our activities. This is also a field in which cutting edge ideas can be found in Kitakyushu City in northern Kyushu, where environmental innovations such as emission reduction methods for vehicles or businesses, and more efficient uses of recyclable materials are taking shape. Kitakyushu City's commitment to protecting the environment comes from far more than theoretical goals, however; it originates with the region's own recovery from the brink of environmental disaster. In the 1960s, air and water here were both extremely polluted, the result of Japan's intensive efforts to rebuild its industrial base. Today, however, the entire region has made a complete turnaround, with Fukuoka City being ranked among the world's most livable cities for its green spaces and natural beauty. This recovery was the result of a cooperative effort between firms and local governments, backed by a populace that was determined to not just return to past splendor, but to become an example for the future.

Welcoming the World

The Japan Regional Initiative – Eco Island Kyushu, a consortium of businesses, government agencies and research institutions dedicated to encouraging international partnerships in northern Kyushu, will be hosting an exhibit space at the upcoming GLOBE 2010 trade fair and conference in Vancouver in March. Their goal in attending this event is to raise global awareness of the opportunities that exist here for eco-related investment and other cooperative endeavors, as well as to educate potential partners of the ease of doing business in northern Kyushu. The group has been working to lower barriers to entry, and provides consulting services for international firms as well as information on the many incentives provided by local and national government bodies to stimulate business and research.

*Census and demographic data, 2009

**Prefectural economic report, 2006

Links:

Fukuoka Hy-Life project
URL: http://www.f-suiso.jp/HyLife.html

Kitakyushu environmental recovery
URL: http://www.convention-a.jp/eng/cpg/con03.html

Fukuoka as "Most livable city"
URL: http://www.welcome-fukuoka.or.jp/english/
URL: http://www.monocle.com/sections/edits/Web-Articles/Top-25-Cities/

GLOBE 2010
VANCOUVER CONVENTION CENTRE, CANADA
MARCH 24-26
11TH BIENNIAL TRADE FAIR & CONFERENCE ON BUSINESS & THE ENVIRONMENT - VANCOUVER

METI Ministry of Economy, Trade and Industry

JETRO Japan External Trade Organization

For more information, visit: www.jetro.go.jp/en/invest/

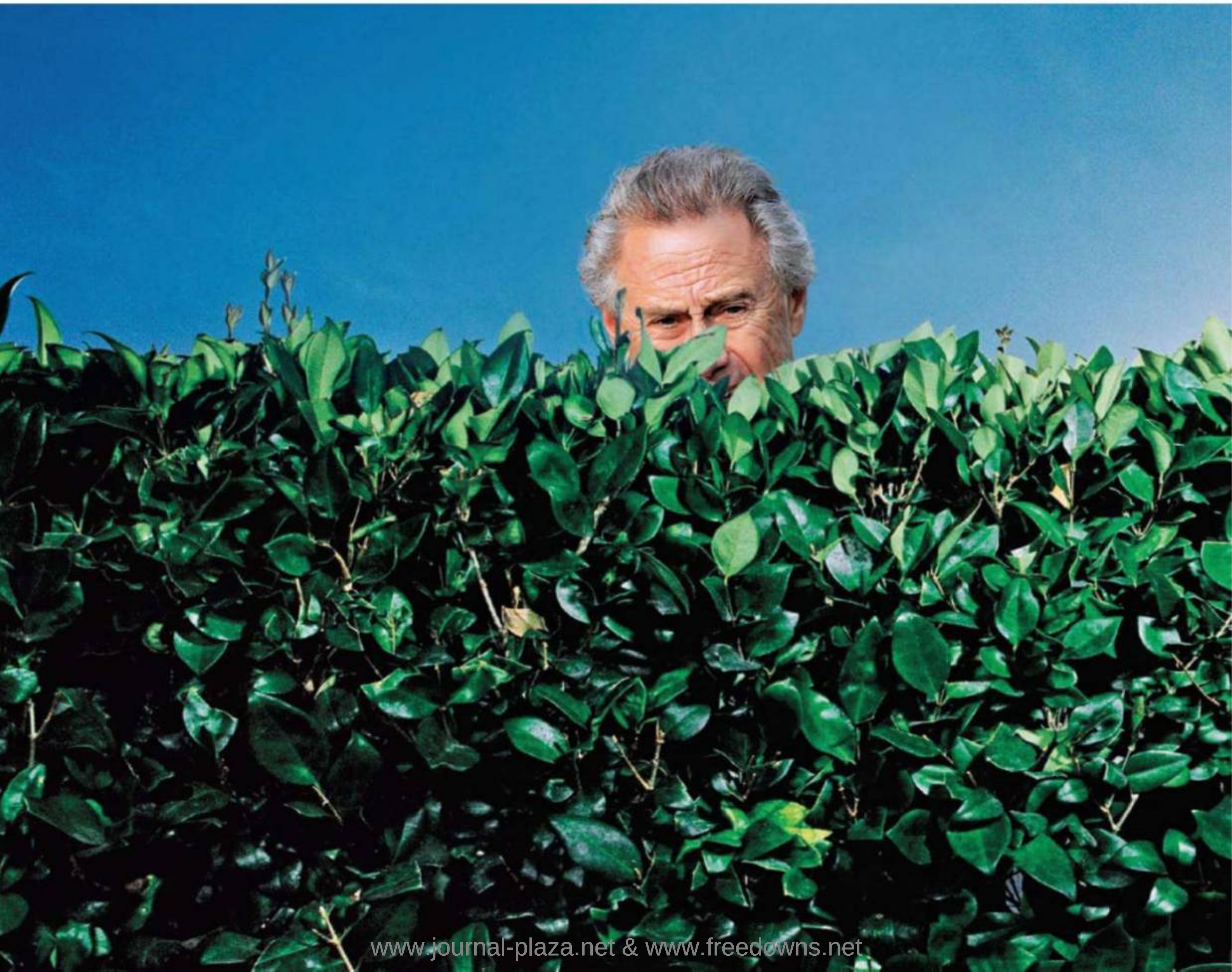
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HIDING BEHIND THEIR HEDGES

HOW SOME EXECUTIVES ARE SELLING THEIR COMPANIES SHORT

By Jane Sasseen

Photo Illustration
by David Rudes/BW



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For investors in Switch & Data Facilities, a telecom services startup, 2008 was a wild year. From a low of 8.60 in mid-March, shares more than doubled, to 18.17 three months later. Further gains seemed likely in late July when CEO Keith Olsen boosted the guidance he had given Wall Street analysts. But with revenue growth slowing even as debt payments and other costs jumped, Switch & Data was in the red by yearend. By November 2008, the shares had fallen to 4.21.

One shareholder avoided much of that drop: the CEO. On June 19, the day the stock peaked, Olsen contracted with an investment bank to hedge 150,000 shares—a quarter of his stock in the company—against losses if the price fell below 18. As part of the complex maneuver, he agreed to sell his shares to the bank one year later and got an advance of $2.2 million. Olsen, who disclosed his hedging in public filings, declined to comment for this story.

Hedges are ways to contain losses if a stock declines, while still keeping some upside potential if the price keeps rising (see table for a full explanation). It's a strategy anyone in the market can employ. But the way hedging is done by CEOs, directors, and other senior executives may deprive investors of clues about impending problems at companies. Many grant executives stock as compensation largely because they want them to have a stake in the company's success or failure. Investors routinely follow insiders' sales and purchases of company stock as a gauge of a corporation's prospects. Hedging, though, reduces an executive's exposure to stock price drops in a way that investors have a hard time detecting. The complex transactions are structured so that executives still technically own the shares. And though some really big hedges get noticed at the time they are made, disclosures of hedging are often vague or buried deep in the footnotes of obscure public filings.

"There is no question these transactions should be a red flag for investors," says Carr Bettis, the co-founder of forensic accounting firm Gradient Analytics and co-author of a recent study on hedging. "The evidence is pretty compelling that hedges tend to be used before bad news hits the market." Bettis' research found that in the year after executives and directors had engaged in hedging, their company's stock often dropped markedly. He also found evidence of an increase in financial restatements and shareholder lawsuits during the same period. Executives at MCI, Enron, ImClone, Krispy Kreme—compa-



Well-protected: Phil Anschutz, ex-director, Union Pacific; John McAleer, ex-vice-chair, Krispy Kreme; William Pulte, founder, Pulte Homes

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nies that suffered some of the great stock meltdowns of the last decade—hedged their shares.

Some 107 instances of executive hedging were reported to the Securities & Exchange Commission in 2009, up from a decade low of 48 in 2007, according to Bettis, and regulators are beginning to scrutinize the transactions. Kenneth Feinberg, the U.S. Treasury pay czar, has banned executives from hedging at the banks and automakers that received government bailouts. "We wanted to make sure they couldn't undercut the links we created between compensation and long-term performance," says Feinberg. If executives at the companies could hedge their stock, he adds, "they wouldn't have to worry about how [the stock] does."

In 2000 and 2001, billionaire Philip Anschutz hedged shares of two companies in which he held major stakes, Union Pacific and Anadarko Petroleum. Shorting stock is typically done as part of a hedging strategy. In Anschutz's case, the bank that arranged the deal, Donaldson, Lufkin & Jenrette (now part of Credit Suisse Group), shorted Anschutz's own shares rather than borrowing shares in the market to short. That was a common technique until tax authorities cracked down on it in 2006. In a case pending before U.S. Tax Court in Washington, the IRS is arguing that Anschutz's deals were effectively stock sales rather than hedges, and is seeking $143.6 million in capital gains taxes. Tax lawyers are watching the case because they say many other executives who early in the decade allowed their own shares to be shorted the way Anschutz did are now being audited. If the IRS wins its case, these hedgers could face big tax bills earlier than expected. Anschutz disputes the IRS's argument and would not comment for this story.

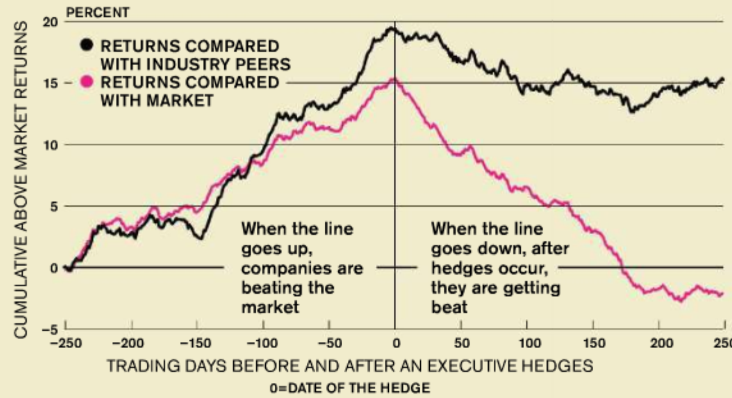
There are plenty of reasons a senior executive would hedge if he thought his company's stock was going to slide. In one type of hedge, called a prepaid variable forward contract, he can get a cash advance of up to 85% for shares he agrees to sell eventually to an investment bank. Because he still technically owns the shares, the IRS doesn't consider a hedge a sale so long as the bank doesn't short the executive's own shares. So the executive need not pay capital gains taxes until the hedge expires. Meanwhile, he can still vote the shares and collect dividends.

U.S. executive hedging first took off in Silicon Valley during the dot-com era, when transactions averaged around 290 a year. Investment banks—Morgan Stanley, Goldman Sachs, JPMorgan Chase, and Citigroup—rushed to provide hedge services. "I don't know of a bank that doesn't have a depart-

PERFORMANCE OF HEDGED STOCKS

This chart shows the average stock performance of companies before and after their executives hedge. In the 250 trading days before an executive hedges through a "prepaid variable forward contract," companies outperform, on average, both the market and rivals in their industry. Once the shares are hedged, they underperform both the market and their peers.

RELATIVE STOCK PERFORMANCE OF COMPANIES BEFORE AND AFTER EXECUTIVES HEDGE



Data: Gradient Analytics, Verus Research

CREDITS, PREVIOUS PAGE: (HEDGE & SKY) MARLA RUTHERFORD/GETTY IMAGES; (ANSCHUTZ, LEFT) MATTHEW STAVER/BLOOMBERG NEWS; (McALEER,CENTER) KIM WALKER/AP PHOTO; (PULTE, RIGHT) GEORGE WALDMAN/PDI. (IMAGE DIGITALLY ALTERED BY *BUSINESSWEEK*). CREDIT, THIS PAGE: CHART BY DAVID FOSTER/BW

HOW HEDGES WORK: SCENARIO ONE

Executives who own big chunks of their company's stock often hedge their holdings to diversify and limit risk if the stock tumbles. Critics worry such transactions weaken the incentives created by equity compensation. They also warn that executives may use privileged information to hedge their shares ahead of bad news. Here are how the two most common hedging strategies work.

Data: Twenty-First Securities, *Bloomberg BusinessWeek*

ZERO-COST COLLARS

This hedge puts a "collar," i.e., a floor and ceiling, around the price an executive gets paid for stock

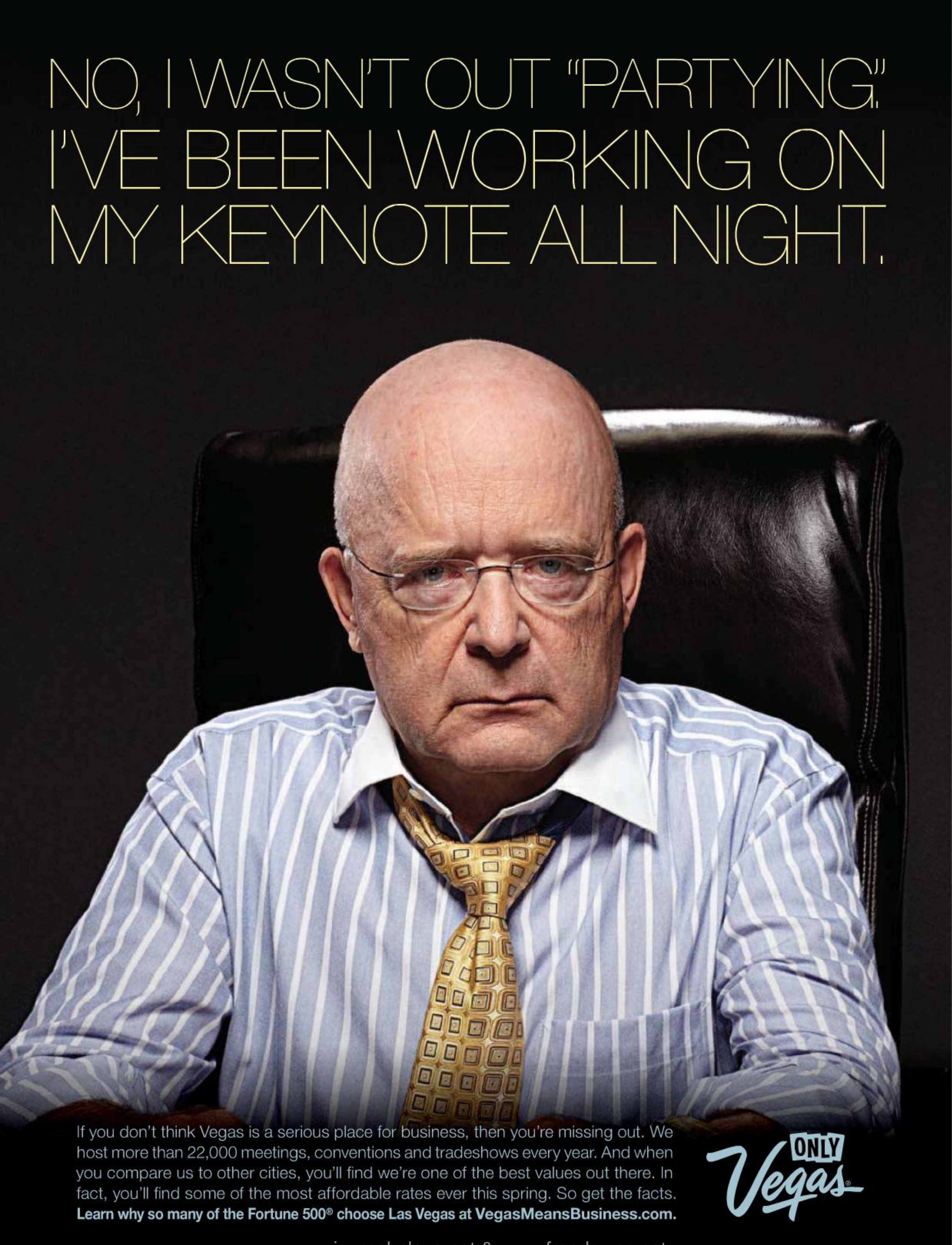
1 An executive wants to protect 2 million shares, currently worth $100 each, against a big drop in the stock.

2 He buys a put option on the stock from a broker, which gives him the right to sell his shares at a given price, say $95. If the stock drops below $95, he sells at that price and suffers no further losses.

3 To pay for the put, the executive simultaneously has his broker sell a call option on his stock. The call gives a buyer the right to acquire the shares at a set price if they rise, say to 110.

4 If the stock goes above $110 while the call option is in effect, the executive must sell his shares to the buyer; if the shares remain between $95 and $110 during the life of the two options, he holds on to all his stock. And during the life of the collar, he can borrow funds—generally up to 50% of the value of his shares.

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ment doing this," says Mark Leeds, a tax lawyer with Greenberg Traurig. By mid-decade, he adds, transactions worth several billion had likely been sold. The hedge business helps the banks cement ties with top executives, which comes in handy when a bank is pitching other services. And the banks reap rich fees.

SUSPECT CORRELATIONS

Bettis and his co-authors examined 2,010 hedging transactions reported in filings by 1,181 executives at 911 firms between 1996 and 2006. In the year preceding executives' hedges, their companies' shares outpaced the market anywhere from 17% to 31% on average, depending on the type of hedge used, according to Bettis' analysis, which was completed last year. After the executives hedged, it's a different story. Shares in companies where the CEOs, directors, and other top executives had hedged using a variable forward sale lagged the market by 16.2%, on average. Those where a collar, another popular hedging transaction, had been used fell behind by 25%.

Roughly 11% of the companies where an executive used a collar had to restate financials within two years of the hedge transaction; comparable companies where no hedging occurred had half as many restatements, Bettis says. Some 11% of the firms that let their executives buy a variable forward contract faced securities-related suits within a year, double the number at companies that didn't hedge. "The poor performance following hedging suggests a number of these trades are potentially based on privileged information," argues Bettis. The trades "appear to be tied to events that were known or could reasonably have been anticipated by the executives," he adds.

SEC officials say executives who hedge fall under the same rules as those who sell their stock. If an executive were to use a hedge to protect himself against losses at a time when he possessed specific material information that the company's performance had stumbled or was about to, that could potentially bring an insider trading charge. But SEC spokesman John Heine says the agency has never pursued an insider trading case against an executive following a hedge.

Missed earnings in the wake of a hedge appear common, Bettis' research shows. Chattem Chairman and CEO Alexander Guerry placed a hedge on 60,000 shares of the Chattanooga (Tenn.)-based maker of Gold Bond foot powder, BullFrog sun block, and other products, according to public filings Guerry made with the SEC. The stock peaked at $81.45 on Feb. 13, 2008, the day after Guerry hedged. Within a month, data compiled by market researcher ACNielsen started to show weaker-than-expected sales. By June the stock was off 30%. Chattem President Robert Bosworth says Guerry's hedge, like four similar transactions he made since 2003, was meant to diversify his portfolio. The stock performed well after those earlier hedges, he points out; moreover, with less than 20% of Guerry's holdings hedged, Bosworth argues that Guerry was still exposed to the fall in share price.

Executives also have hedged shares just prior to the eruptions of some real messes. At Krispy Kreme in September 2003, a family partnership run by then-Vice-Chairman and Executive Vice-President John McAleer hedged 1.5 million of the doughnut chain's shares, receiving an advance of $50 million from its investment bank. The deal hedged against further losses if the shares dropped below $39.30. According to McAleer's public filings, that protection lasted on one tranche of 750,000 shares until September 2007, while a second tranche of 750,00 shares was protected against further downside until March 2008. At the time the stock was trading around 42. By November 2003, as questions mounted about earnings, the stock had started to drop. The SEC launched an investigation,



Gradient's Bettis: Burrowing into the filings

BRENDAN MOORE

HOW HEDGES WORK: SCENARIO TWO

PREPAID VARIABLE FORWARD CONTRACT (PVF)

This is the more popular—and complex—hedge strategy.

A PVF sale revolves around a contract established between a senior executive and an investment bank, and it frees up more cash without initially requiring that the executive sell his stock or pay capital-gains tax.

1 Now the executive hedges those 2 million shares worth $100 apiece with a three-year PVF. He agrees on a floor and a ceiling price with the bank—again, say $95 and $110.

2 The executive receives a cash advance from the bank that generally equals up to 85% of the value of his stock at the time of the hedge, or in this case, $170 million.

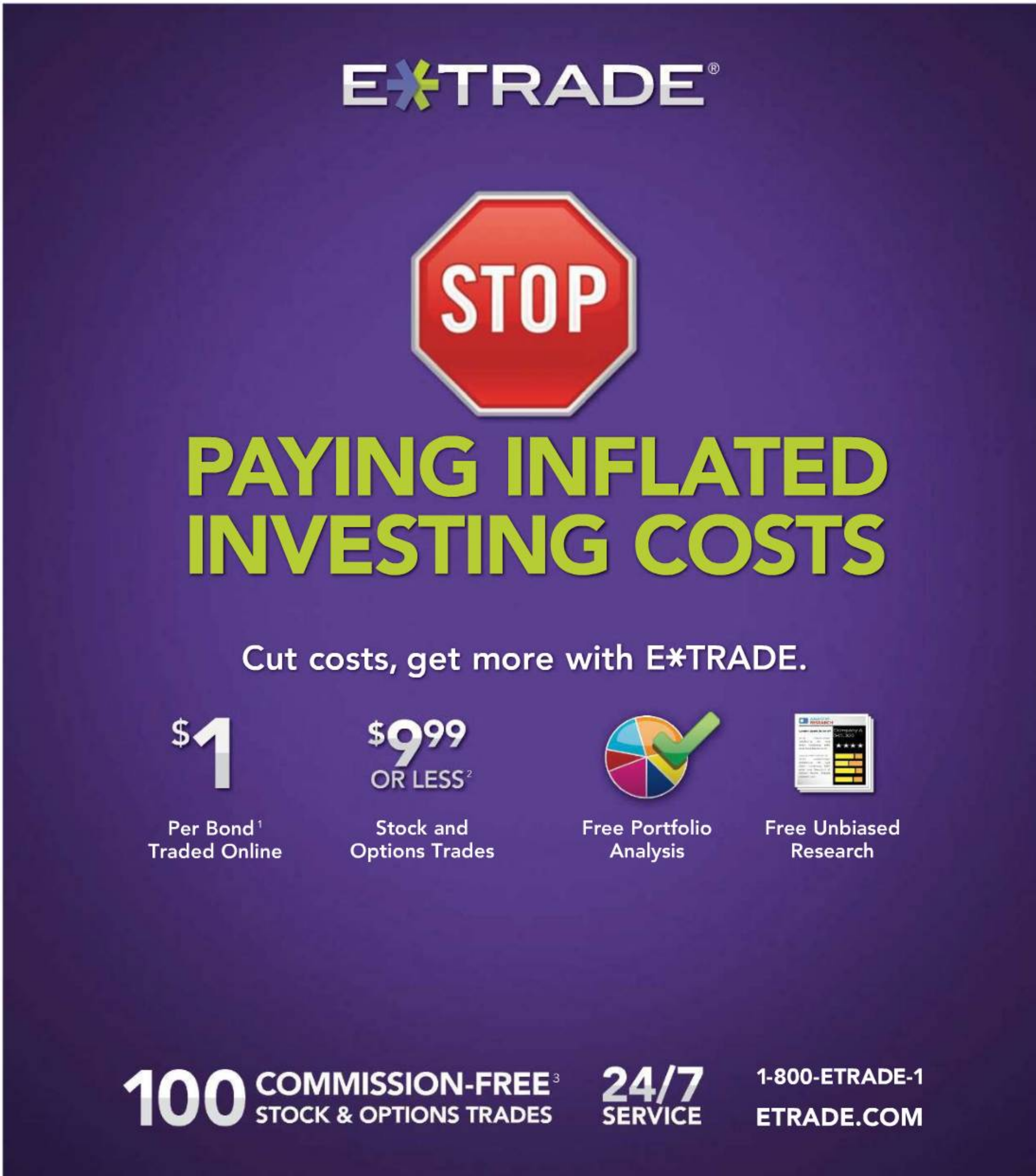
3 In the meantime, to protect itself from a loss if the shares fall below $95, the investment bank will generally short the company's shares. It also collects fees on the contract.

4 At the end of three years, if the shares fall below $95, the executive simply turns over his 2 million shares. He keeps the cash he received in advance and has limited his downside.

5 If, on the other hand, the shares have risen, he can settle up with the bank in cash. He hangs onto the shares and profits from any further rise in the stock.

6 Or he can pay the bank back in stock; the exact number of shares will depend on how the stock performs. The better the stock does during the life of the hedge, the fewer shares he'll owe.

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Krispy Kreme restated earnings, and three executives eventually settled charges of securities fraud. When the second tranche of the hedge ended in 2008, the shares were trading at $2.59. McAleer, who was not cited in the SEC investigation, left the company in 2005; he was a defendant in a shareholder class action against the company and its former executives and directors that was settled in 2006 for $75 million.

McAleer's lawyer, Timothy Ehlinger, said in a written statement that the family partnership, which had been funded by stock inherited from his father, was advised by JP Morgan in early 2001 to diversify its holdings in the company's shares. The partnership hedged shares in September of 2001, 2002, and 2003 successively, according to plan. The fourth transaction, set for 2004, was cancelled. "Jack McAleer did not have any material nonpublic information regarding [the] stock," says Ehlinger. who adds that McAleer did not hedge any of the 500,000 shares he owned in his own name.

Bettis, who is also an associate research professor at Arizona State, readily acknowledges that it is impossible to know exactly what's behind any individual's trades by looking at public filings. Many executives say they hedge to diversify holdings heavily weighted toward their company's shares. "These deals are dictated by so much more" than what's happening at the company, says Robert Gordon, whose firm, Twenty-First Securities, sets up hedges. "I don't think people do them because they're bearish, but they do want to take some chips off the table." When Alan G. Hassenfeld hedged over 1 million shares before his 2006 retirement as executive chairman of toymaker Hasbro, for example, the company said the move was "to diversify his investment portfolio, realize liquidity ... and provide funding against charitable pledges."

To track most hedges, an investor generally has to look up a Form 4, an SEC filing where top executives are required to report sales, purchases, and other transactions in the company's stock. Many details on hedges aren't actually listed in the two tables that make up Form 4. They show up instead in footnotes, and details are often incorrectly reported or missing, says Bettis. According to SEC regulations, companies must include such information as the exercise price of a hedge and the "dollar value locked in," the term of the transaction, and the number of shares the executive would have at the end of the hedge. There's no mandated format, however, for conveying that information, which seems to have left companies unclear as to the requirements. Morad Tahbaz, a director of Air Methods, a provider of emergency medical travel, disclosed he was hedging 55,000 shares on Sept. 25, 2007. His filings didn't say how long his hedge lasted or what the floor price was beyond which he would be protected against a drop in the stock. The company says it believes it met all disclosure rules.

Chester Spatt, the SEC's chief economist from 2004 to 2007 who teaches finance at Carnegie Mellon's Tepper School of Business, believes details of hedges should be spelled out more clearly. "It's potentially misleading if a proxy says a guy owns 1 million shares but only has an economic interest in half that," says Spatt. Meredith Cross, director of the SEC's Corporate Finance Div., says the agency is starting several studies to see if disclosure rules are adequate. Still, she says, "shareholders have access to substantial information about executive hedging."

Some companies, including Procter & Gamble and Kellogg, ban executive hedging, but they are a minority. Lucian Bebchuk, head of the Program on Corporate Governance at Harvard Law School, predicts growing problems with hedges as companies make executives hold on longer to shares as a way of prodding them to work for long-term gains. A manager might have to keep a stock award for three years after it vests, for example. If he can hedge his shares and essentially cash out of them before the holding period ends, he eludes that restriction. That's why Bebchuk sees an all-out ban as the only solution. "Allowing executives the freedom to hedge," he says, "defeats the purpose of equity compensation." |BW|

HEDGING THEIR BETS

These two examples of well-known companies show how share prices often drop after top managers hedge. But the details surrounding each hedge can be complicated and hard to interpret.

COMPANY NAME	DESCRIPTION
Pulte Homes	After a several-year slide, shares of the home builder nearly doubled in early 2008, to around 16. On Feb. 26, founder and Chairman William Pulte hedged 3.35 million shares in exchange for $33 million in cash. Losses for that quarter swelled to $2.75 a share, three times what analysts expected; within months, the stock was again below 9. Pulte missed earnings three out of four quarters that year. Two later hedges have yielded Pulte another $85 million. Pulte, who is retiring from the board at the end of March, says the transactions were driven entirely by his personal situation, as part of his ongoing estate planning and to fund charities.
Boston Scientific	Starting on Sept. 9, 2008, with shares trading at $12.40, director and co-founder Peter Nicholas entered the first of numerous hedges that occurred through the yearend and in much of 2009. Within a month, shares plunged as supplies of a new stent fell short, the company lost a legal battle with Johnson & Johnson, and earnings fell below expectations. He and co-founder John Abele were forced into large stock sales to meet margin calls. Abele, too, has since hedged extensively. The shares now stand at $7.80. Nicholas says he has used hedges for seven years to diversify his portfolio and generate cash, and does so rather than sell outright because he remains a strong believer in the company. Abele said his hedges generated needed liquidity to maintain his philanthropic and other commitments after the margin calls; he also believed the company would do better. Both say many of their hedges were executed over numerous months through prearranged trading plans known as 10b5-1 plans, designed to allow executives to schedule trades when they are not in possession of material inside information.

Data: Company filings, Gradient Analytics, Verus Research, Bloomberg

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WHAT'S NEXT

INNOVATION & TECHNOLOGY

A 'Condom' That Keeps PCs Safe

Many have tried, but no one has yet hacked past InZero's protective layer

By John Carey

When even Google falls victim to hackers, it's clear that traditional security software isn't getting the job done. Hackers, criminals, and spies have broken into the computer systems of thousands of companies, government agencies, and organizations. Eighty-five percent of companies and agencies surveyed by the Ponemon Institute, a research firm, have suffered security breaches and data losses over the previous year—roughly one-quarter of which involved hackers. The losses are pegged at more than $1 trillion per year. "The bad guys are getting better and better, and my money is on the bad guys," says security expert William R. Cheswick of AT&T Labs.



InZero's device aims to protect computers from the "mayhem" on the Web

Against this darkening backdrop, a tiny, Herndon (Va.) startup called InZero Systems claims to have developed a hackproof hardware-based system—a boast that strikes some experts as far-fetched. In general, any company that says it can thwart all intruders "is run by idiots who don't deserve a second glance," warns Bruce Schneier, chief security technology officer at BT, the British telecom giant.

Schneier has not evaluated InZero's technology. Many who have, however, say they are impressed. Its approach has been tested by the military's Defense Advanced Research Projects Agency (DARPA) and several companies that specialize in finding cracks in computer security. No one has broken in. "It was very secure, but we were concerned about its user friendliness," says former DARPA director Anthony J. Tether, who bought 10 devices to test just before he left the agency in early 2009. "As best we can tell, there isn't a way to circumvent it," says Ronald J. Dorman, vice-president of Telos, a computer and network security company hired by InZero to evaluate the system.


Shevchenko: Giving hackers, criminals, and spies the middle finger

PHOTOGRAPHS BY JEFF HUTCHENS/REPORTAGE BY GETTY IMAGES

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The idea behind InZero was hatched in 2002 by Oleksiy Shevchenko, a computer engineer in Ukraine who was trying to address the Internet security concerns of a policeman friend. He steered clear of the traditional defense strategy, which uses software to look out for new viruses or intruders, then devises ways to thwart each. Because malware comes in many disguises, this approach leaves networks exposed in the early stages of a new attack. Instead, Shevchenko set up hardware that acts like a second computer (in geekspeak, a "sandbox") sitting between a vulnerable computer and the Internet.

When you venture out on the Web, it feels like you are using your own machine, but you are actually in InZero's sandbox. You can send e-mail and go anywhere in cyberspace, even to sites known to harbor hackers and viruses. The effect is similar to having a Webcam on your computer aimed at a second computer's screen, says cryptography expert Phil Zimmermann, who was asked by InZero to assess the technology. There's a barrier between the two systems that prevents anything bad from getting to your machine.

Since the operating system and memory in InZero's sandbox are read-only, they can't be changed by a virus, and hackers can't commandeer the device. "Whatever mayhem is on this other computer is not going to hurt you," says Zimmermann, who says he can't think of any way to break in. InZero CEO Louis R. Hughes offers a second analogy: that of a patient with an unknown disease quarantined behind a glass wall. "Our device is the equivalent of that glass wall," he says.

SECOND SIGHT

The idea of a second device acting as a barricade isn't new. Security experts often set up a buffer computer to interact with the larger world; if and when the machine gets infected, they simply wipe it clean and reinstall software. Many researchers have also latched onto the idea of a software sandbox—or virtual computer—that resides right inside a PC, says AT&T's Cheswick. What's different about InZero's approach is that it offers the protection of a second real computer, without having to go through the hassle of constantly wiping it down. The device that performs this task is no larger than a typical paperback book. "There isn't anyone else who has a solution like this in hardware," says Telos' Dorman.

Shevchenko dubbed the technology XB, after a Russian expression equivalent to a middle-finger salute. He found an angel investor in Ukraine, Alexander N. Dubrov, who came up with his own nickname: "Internet condom." Shevchenko filed patents and built three working prototypes. Then he ran a hacker contest, offering a Harley-Davidson to anyone able to penetrate the system. No one did.

Alexander V. Pyntikov, a top Soviet Union government innovation official-turned-entrepreneur, got wind of the promising technology. Pyntikov intro-

BREACHING THE WALLS

Dealing with cyberattacks costs companies and governments billions of dollars a year and threatens national and economic security. Some recent incidents:

THE 'KNEBER BOTNET'

Named after the e-mail message that launched it, this attack affected 2,411 companies and 75,000 computer systems over 18 months, according to security firm NetWitness. The source is thought to be a criminal syndicate in Eastern Europe.

GETTING INTO GOOGLE

Hackers attacked the Google e-mail accounts of Chinese human rights activists, after which the search giant threatened to leave China. The attacks were sophisticated and penetrated not just Google but 34 other companies.

STEALING INFORMATION

In January 2009, credit-card processor Heartland Payment Systems discovered hackers had broken in. Investigators say they may have snared millions of cards. Heartland agreed a year later to pay up to $60 million to issuers of Visa credit and debit cards to resolve claims.

Data: NetWitness, Google, Heartland

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duced Shevchenko to Hughes, former president of General Motors' international operations and of Lockheed Martin. "I was very skeptical," recalls Hughes. "Here was this young guy saying he had invented a computer that totally protects from attacks."

Hughes became a believer after he arranged a test in 2003 at British Telecom's Ipswich labs and the company's computer scientists were unable to break in. He brought Shevchenko to the U.S., invested millions of his own dollars in a new U.S. company, InZero, and became its CEO, with Pyntikov as chief operating officer and Shevchenko as chief technology officer. (The name InZero nods to the claim that zero intruders can get in.) Since then the company has filed additional patents and spent several years simplifying the steps a user must take to operate the device. The current version has four processors and 60 million lines of software code. "It's a complicated little box," says Hughes.

At his office, the burly Shevchenko demonstrates how easy it is for a virus to penetrate a computer equipped with the latest updates of antivirus software and then send back information like credit-card numbers. The same virus is powerless against a computer equipped with the InZero device. Even so, he volunteers, "Our solution is not a panacea." It doesn't protect against so-called denial of service attacks, in which legions of PCs are infected with programs that can swamp a Web site by means of a coordinated assault. For just about everything else, from viruses to spying, the company claims the technology is a game-changer.

One of the most thorough evaluations to date was performed under contract by escrypt, a security company in Ann Arbor, Mich. Escrypt drums up new business finding security weaknesses and devising fixes, says CEO André Weimerskirch. So it was frustrating and surprising, he says, when a team of four people attacked InZero's system for more than two weeks without discovering a flaw.



Pyntikov: "We have to show that nothing will be reported to Putin"

JEFF HUTCHENS/REPORTAGE BY GETTY IMAGES

Despite the successful tests, InZero still has hurdles ahead. The company has to prove to the U.S. government that its engineers, many of whom are in Kiev, haven't built in a back door for spies.

"We have to show that nothing will be reported to Putin," says Pyntikov. Cost and complexity are also on Pyntikov's mind. The company hopes to market a family of devices for PCs, servers, and entire networks, with prices starting in the low hundreds. In two or three years, the hardware could be embedded into laptops, adding as little as $25 to hardware costs, says Pyntikov. If companies and consumers take the trouble to buy and set up the devices, there may finally be a gate that hackers can't storm. **BW**



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SPECIAL MARKET OPPORTUNITY

First Federal

The Insider's View of the Coin Market's Leading Trends

Nicholas J. Bruyer, CEO,
First Federal Coin Corp.
ANA Life Member
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$34,500 FOR AN OUNCE OF SILVER BULLION? IMPOSSIBLE!

10 years ago I'd have called you crazy to make such a prediction. Yet today it's a fact. Now our deal with a $4 billion precious metals wholesaler nets you 40% off market price for America's hottest ounce of silver!

It wasn't more than ten years ago that I was meeting in my office with former U.S. Mint Director Donna Pope. She was speaking with pride about what she considered to be her greatest achievement as Director under President Reagan: Creation of the American Eagle silver and gold bullion coin programs, the first of their kind in our nation's history.

The purpose of these coins was to give people the opportunity to own physical silver and gold in a form certified for weight and purity by the U.S. Mint. While the bullion coin program was a signal success, nobody took into account the profound effect it would have on the collector market.

Silver Eagles = Today's Morgan Dollars

In the 1800s and early 1900s, the U.S. Morgan Silver Dollar was struck year upon year at various mints and circulated at face value. Their core value was in their precious metal content. However, in top grades, Morgan Silver Dollars can sell today for tens and even hundreds of thousands of dollars each!

For the same reason, many collectors today see the Silver Eagle series as a literal "ground floor" opportunity to acquire the top-grade coins as they are released. They started submitting Silver Eagles to the leading independent grading services, PCGS and NGC, praying that the coins would come back with the highest possible grade: MS70 (all Uncirculated coins are graded on a point system from a low of 60 to a high of 70, with 70 representing flawless perfection). Of all the Silver Eagles produced by the U.S. Mint in 2009, less than one out of every 2,098 earned the NGC MS70 grade!

MS70 = $$$$$!

In the rarified atmosphere of MS70, Silver Eagles have soared to market prices that I can only characterize as surreal. Consider this: NGC graded MS70 Silver Eagles have been selling for truly stratospheric prices. Here are just a few eye-popping examples:

1991 MS70 Silver Eagle	$34,500
1999 MS70 Silver Eagle	$27,600
1996 MS70 Silver Eagle	$11,995
1988 MS70 Silver Eagle	$3,995
1994 MS70 Silver Eagle	$3,700

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***Needle in a Haystack*. NGC examines thousands of Silver Eagles to find the one that earns the coveted MS70 grade.**

As I write this I literally don't know how many Perfect MS70 coins we'll get, but I do know that I have a limited supply of these "perfect" 2010 Silver Eagles for just $149 each when you buy 1-4 coins. Buy 5-9 for $139 each and save. Buy 10+ for $129 each and you save even more. In fact that's 40% off the current market price of $215 for MS70 2010 Eagles.

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Eli Lilly's Drug Assembly Line

Faced with patent expirations that will ravage sales, Lilly is reorganizing for speed

By Arlene Weintraub and Meg Tirrell

Shortly after becoming CEO of Eli Lilly in April 2008, John Lechleiter, a former lab scientist, sent senior executives a gift. It was a digital clock counting down, second by second, to Oct. 23, 2011. That's the day Lilly's $5 billion-a-year schizophrenia pill, Zyprexa, goes off patent. Next to the countdown were four words: "Do what we do."

The staff got the message. Lilly stands to lose $10 billion in annual revenues between now and the end of 2016—almost half its 2009 sales—as patents on three key drugs expire. To replace that, the company must pick up the pace of drug development.

The top six U.S. drugmakers all face such "patent cliffs," but Lilly's is one of the steepest. Making things worse, two of its promising experimental drugs failed last year in late-stage trials. Lilly's shares fell 11% in 2009, making it the worst performer among the 11 U.S. drug companies in the Standard & Poor's Pharmaceuticals Index. "Investors seem to price Lilly's stock as if it will never develop another drug," says Michael P. Krensavage, manager of Krensavage Partners, a hedge fund that owns Lilly shares.

When the company has faced such challenges in the past, "each and every time the answer has been new, innovative products," says Lechleiter, whose mission is to introduce two products a year starting in 2013. To reach that goal he has radically restructured the company, dedicating two out of five new business units specifically to developing drugs for cancer and diabetes. Rivals such as Pfizer and Johnson & Johnson have also refocused their research efforts around specific therapeutic targets. But there's a difference: Lilly hopes to turn drug development into something akin to automobile manufacturing—an assembly line of tasks that work in concert to make the final product quickly and efficiently.

As a first step, Lechleiter in September placed every department that plays a role in turning molecules into medicines under one roof, from the people who assess side effects to the folks who deal with the Food & Drug Administration. One goal at this new outfit, called the Development Center of Excellence, is to take a standard three-phase drug testing process and compress it to two for certain products.



CEO Lechleiter: Will his obsession with efficiency work?

The idea proved its value last year. Instead of completing one trial to determine the best dose for a diabetes drug, then launching a separate trial to determine efficacy, Lilly tested several doses at once. A team of statisticians continuously assessed the data, allowing researchers to eliminate dosages that weren't working. Once the optimal dose was known, researchers continued to test it on the same group of patients, rather than recruiting new ones for a separate phase. Timothy J. Garnett, Lilly's chief medical officer, says this approach could save the company 14 months.

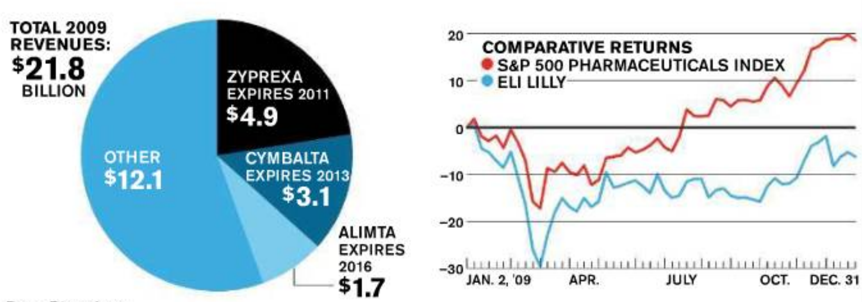
UNPREDICTABLE PROCESS

The company is also adopting a technique known in industrial manufacturing as "critical chain." Say a team of people ordinarily is given three weeks to produce a 30-page report on a clinical trial. The critical chain process assumes precious time is lost as team members responsible for writing, publishing, and signing off on the report try to multitask, says Garnett. Tell each one exactly when he or she must complete a particular task, and three weeks may shrink to just seven days. "If we say, 'you only have a week, but that's your No. 1 priority,' it will only take a week. There's a self-fulfilling element to it," Garnett says.

Some experts worry critical chain will be a bad fit with drugmaking. The process of developing a new medicine is fraught with uncertainties, and time lines can be thrown off-kilter by external forces, such as delays at the FDA. Assembly-line processes "work better in jobs that are predictable"—unlike the pharmaceutical business, says Richard "Erik" M. Gordon, assistant professor at the University of

LOOMING LOSSES

Three of Eli Lilly's blockbuster drugs are facing patent expirations, and investors are nervous about the stock



Data: Bloomberg

CHART BY DAVID FOSTER

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MATTHEW GILSON

Michigan's Ross School of Business.

Lechleiter's obsession with efficiency dates back to the 1970s, when he pursued his PhD in organic chemistry at Harvard University. His lab focused on reducing the number of steps needed to make new compounds—an experience he found useful when he joined Lilly's agricultural division straight out of graduate school, working on herbicides. One of his first challenges was to devise a more cost-effective way to make a particular molecule. "He solved that problem and simultaneously developed an enabling technology that allowed others at Lilly to progress with their research," recalls Lechleiter's mentor and former PhD adviser, Paul A. Wender, now a chemistry professor at Stanford University.

Since becoming CEO, Lechleiter has emerged as a communicator within the company. He maintains two blogs on Lilly's intranet and attends Wednesday morning meetings where Lilly scientists present their work. Although it has been more than two decades since he sat at a lab bench, he says he's not afraid to ask a question or two. "Usually I preface it by saying something like, 'Excuse me if I'm really ignorant,'" Lechleiter says.

These days, it's Wall Street types, not complex chemistry, that hand Lechleiter his toughest challenges. Lilly spent 21% of revenues on R&D in the most recent quarter—far outpacing the industry's average R&D outlay, which is closer to the midteens. "A lot of investors say: 'Unless you cut back, you may be spending 24% of sales on R&D,'" says Lechleiter. "I say: 'So what? That's what we're here to do.'"

Barclays Capital analyst Tony Butler says the impact of the efficiency-focused initiatives is unclear: "It's clever, but how much money will it save? We need to see the fruits of research in risky areas like Alzheimer's."

Lechleiter has yet to deliver the results Wall Street craves. Last summer, Lilly shelved a multiple sclerosis drug and an osteoporosis treatment when they came up short in clinical trials.

THE TOP SIX U.S. DRUGMAKERS ALL FACE "PATENT CLIFFS," BUT LILLY'S IS ONE OF THE STEEPEST

And the new blood-thinning drug, Effient, has made little headway against Bristol-Myers Squibb's $6 billion-a-year Plavix. Meanwhile, the turnaround clock keeps ticking: Lechleiter has about 600 days to prove his strategy can protect Lilly when it's far out on the edge of the patent cliff. | BW |

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With Dell in the Dust, Acer Chases HP

The Taiwanese company is now No. 2 in PCs, but it's aiming for the top—in both computers and gadgets

By Bruce Einhorn and Tim Culpan

TAIPEI

It's a Saturday night in February, and 2,000-plus Acer employees have crammed into an exhibition center for the company's Lunar New Year party. As guests sit down to chestnut soup, steamed abalone, and double-boiled young chicken, a troupe of local comedians impersonates Acer executives.

Among the roasted is Gianfranco Lanci, the 55-year-old Italian who is the company's first non-Taiwanese CEO. His impersonator pastes a fake bald patch on the back of his head and mutters a few phrases in Italian, then switches to English. "In my opinion, Acer is already No. 1," the fake Lanci declares, taking a jab at Acer's aim to jump ahead of Hewlett-Packard into the top position in the PC industry.

Lanci and Acer Chairman J.T. Wang aren't quite there yet, but they're getting closer. Acer now sells 13.4% of the world's PCs, ahead of Dell's 12.4% but far behind HP's 21%. On Feb. 9 the company reported its biggest quarterly profit in almost three years, with earnings up 25% to $109 million. Shipments increased 28%, well ahead of the industry average of 15%, as consumers flock to Acer's inexpensive offerings.

This year, Acer hopes to grab the top spot in laptops. That shouldn't be hard: It's already the leader in netbooks—the small, low-cost machines it launched in 2008—and it's neck and neck with HP for all portable computers. Once Acer becomes No. 1 in that segment, Chairman Wang boasts, it won't be long before it dethrones the Americans. "Within two to three years we will be able to take the total PC No. 1 spot," he says. "Whether it's 2012 or 2013, it doesn't make too much difference to us." HP declined to comment about the chairman's audacious predictions.

Wang, 55, understands that hubris could be Acer's undoing. So on his office wall hangs a framed copy of Taipei's *Economic Daily News* from September 2002, when Acer was at best a second-tier player. The page highlights Acer's plans for a new tablet PC—a product that quickly flopped. The lesson Wang drew: let others take the lead on the newest, niftiest gadgets and stay focused on the basics of churning out quality computers at low cost. "I cannot waste resources," he says. When it comes to launching the latest innovations, "We can be No. 2. It's O.K. with us." That's why Acer let a Taiwanese rival, Asustek, make the first move in netbooks. Once the machines proved a hit, Acer swooped in and became No. 1.



Wang and Lanci: With smartphones and e-Readers, consumers won't be forgotten

PAUL HU/ASSIGNMENT ASIA

Being the leader doesn't mean much if you have to kill your margins to get there. That's why some investors fret that the effort to overtake HP will mean a price war that devastates earnings. Acer's operating margin in the fourth quarter was 2.95%, an improvement from 2.24% in the third quarter but far behind the 4.71% of HP's computer division. Worries about profitability have helped push Acer's Taipei-listed stock down 13% since a Jan. 15 high, vs. a drop of 10% for HP and Dell. "We don't think [sacrificing profits for market share] is the right strategy for our shareholders," says Stephen J. Felice, head of Dell's consumer and small business division. At the same time, he adds, "We are not ceding second place" to Acer.

As Lanci and Wang race to stay ahead of Dell and unseat HP, they have transformed what was formerly a bastion of Taiwanese management into the PC industry's most global com-

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pany. While the top ranks at HP and Dell are dominated by Americans and Lenovo's leadership is largely Chinese, Acer's team includes a French executive who oversees mobile phones, an Italian marketing chief, a German running China, an Austrian leading the U.S., and an American managing Brazil. "If you want to run a global company," Lanci says, "you need global talent."

That global team will need to make some changes to their business model if Acer is to reach its goal. The company is strongest in sales to consumers, using four brands to cater to various segments: eMachines for those who focus mainly on price, Gateway (in the U.S.) and Packard Bell (Europe) for the middle tier, and Acer for technophiles. The multibrand approach was developed after Acer bought Gateway in 2007 for $710 million, and it has helped the company gain shelf space in stores, says marketing chief Gianpiero Morbello. "It's difficult to get a retailer to place 50% of his space with one brand," says Morbello, who spent much of February entertaining customers at the Olympics, which Acer is sponsoring. "It's easier to split that same space with three brands."

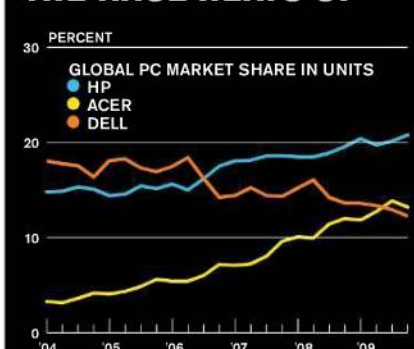
TEAM EFFORT

Corporations, though, don't do their PC shopping at Best Buy or Wal-Mart. Acer's focus on consumer sales hasn't been a problem in the past couple of years, as businesses have slashed tech spending. But the brighter economic outlook and the launch of Windows 7 will likely spur a rebound in business orders this year. Serving corporate buyers is more labor-intensive than selling to consumers, since companies require big teams to manage logistics and customer support. "They want ... exactly the same model of PC worldwide, with the exact same support and service," says Tracy Tsai, an analyst in Taipei with market researcher Gartner. That's something Acer has avoided, so many would-be buyers don't know Acer's products. As Acer's profile grows, Tsai says, "It might be a good chance to get some credit and earn the trust [of corporate buyers]."

Lanci aims to do just that. In November he began rolling out a new line of servers—bigger, more robust machines used by companies for data storage, number crunching, and network management. By yearend, Lanci expects servers to account for about 4% of Acer's revenue, offering margins that are roughly double what the company earns on PCs. Lanci predicts that the new servers, plus additional staff devoted to corporate sales, will quickly pay off. "We always have kept corporate low-profile, because we wanted to develop other parts [of our business] first," he says. This year, he promises, "Our effort will be big on commercial."

That doesn't mean Lanci is forgetting consumers. Acer is developing a Kindle-like e-Reader, laptops running Google's Chrome operating system, and devices to compete with Apple's iPad. In 2009 Acer launched its first smartphones. Lanci expects to sell more than 2 million of them this year, and by 2013 he aims to get 10% of revenues from smartphones. Soon Acer will open an Apple-like app store offering programs to run on these new gadgets. As all kinds of new devices hit the market, Lanci says, he's less concerned with dominating the PC business and more interested in being the leader in electronic gadgets of all kinds. "The industry is going to change a lot in the next five years," Lanci says. "To become No. 1, we need to continue to focus on mobile ... the smartphone is just the beginning of the story." BW

THE RACE HEATS UP



Data: IDC

CHART BY DAVID FOSTER

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STRATEGY & COMPETITION

Rambo Rifles for Weekend Hunters

The "Modern Sporting Rifle" is a hot seller. Please, just don't call it an assault weapon

By Paul M. Barrett

As heavily armed U.S. troops deployed in the Middle East remain in the news, the military-style semiautomatic rifle has become a hot seller in the civilian market back home. Most major manufacturers have launched new models.

Sturm Ruger, one of the largest American gunmakers, introduced the SR-556 last May. It retails for about $2,000 and features a flash-suppressor, telescoping stock, pistol grip, and three 30-round magazines. It looks like the weapons that U.S. soldiers use to shoot Taliban insurgents.

"This is the one the younger generation wants," says Ruger spokesman Ken Jorgensen. "It's not their dad's gun or their granddad's gun." That's the sales pitch—and a source of controversy.

Even within the ranks of hunters and other gun enthusiasts, some protest the pursuit of deer with a modified form of the basic U.S. military weapon. The touchstone for this debate remains a February 2007 blog post by legendary hunter Jim Zumbo. "Maybe I'm a traditionalist, but I see no place for these weapons among our hunting fraternity," Zumbo wrote on the *Outdoor Life* Web site. Gun owners erupted. *Outdoor Life* excised his online comments and parted company with the columnist.

Though digitally expunged, Zumbo's objection persists. The National Shooting Sports Foundation, a trade group, devoted an entire press conference to it during the gun business' annual convention in Las Vegas in January.



The Ruger SR-556 Semiautomatic

Magazine capacity:	**Stock:**	**Weight:**	**Overall length:**	**Suggested retail:**
30 rounds, 5.56mm	Black synthetic, collapsible	7.94 lb.	32¾ in.-36 in.	$1,995

"These rifles are there; they are not going away," Stephen Sanetti, the NSSF's chief executive, told reporters. "We just want to make sure the hunting community hangs together."

The solution, Sanetti says, is to rebrand the weapons as "modern sporting rifles," or MSRs. In an online campaign, his organization points out that MSRs are durable, reliable, and use ammunition similar to that used with more traditional rifles. "It won't be long before people call one of these 'ol' Betsy,'" the narrator of an NSSF video says as he cradles a semiautomatic. Americans spend about $2.5 billion a year on guns; precise figures aren't available on semiauto rifles.

For generations, rifle models first used by soldiers have become profitable sellers in the domestic market. The 1903 bolt-action Springfield adopted by the U.S. Army in World War I begat the wooden-stock rifle carried by generations of deer hunters. The higher-capacity Garand issued to troops in World War II also spawned versions used to hunt big game.

The modern sporting rifle, assuming the label sticks, traces its roots to the M-16 that first saw combat in Vietnam. The main difference between the military weapon and its civilian counterpart is that the Pentagon's version has the capacity to fire bursts of bullets with a single pull of the trigger. The cosmetically similar MSR fires only one round with each trigger pull.

Some of the confusion over these rifles stems from the tendency of gun-control advocates to refer to all of them—fully automatic and semiautomatic—as "assault weapons." The confusion has been compounded by some manufacturers that use SWAT-team imagery in their advertising and stress how closely their civilian products match military specifications. Since the election of 2008, gun retailers have helped drive semiauto sales by stirring the fear—so far unrealized—that President Barack Obama would try to ban them.

Will the MSR designation mollify old-school backwoodsmen? Zumbo predicts it will. Reached at his home in Cody, Wyo., he says he's now used to other hunters carrying what he still calls "black guns." |BW|

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Your Handy Guide to Russia's Oligarchs

With the country's market soaring, Russian billionaires are opening their wallets—and planning their legacies

By Yuriy Humber

Russia's tycoons lost billions in the global financial crisis. Their fortunes, though, have revived in the last year as the country's RTS and Micex stock indexes have jumped 120%. That means Russian billionaires are again snapping up art, sports teams, and yachts. But as they settle into their 40s and 50s, they're also making corporate acquisitions with an eye toward creating their legacies. Here are some recent maneuvers by leading Russian magnates, plus estimates of their net worth by Russia's *Finans* business magazine.



1 MIKHAIL PROKHOROV
President, Onexim Group

AGE 44

EST. NET WORTH $17.9 billion

BUSINESSES Metals, gold, real estate

LATEST DEAL New Jersey Nets

■ Prokhorov may become the first Russian owner of a U.S. basketball team. The 6'7" magnate is awaiting NBA approval of his proposed $200 million purchase of 80% of the New Jersey Nets and 45% of the team's planned arena in Brooklyn. (He would also assume 80% of the team's estimated $207 million debt and fund up to $60 million in future Nets losses.) Prokhorov intends to do more acquisitions in the U.S., likely in energy and nanotechnology, and aims to build Russia's first electric car. He fared better than most of his fellow oligarchs in the crisis after selling his 25% stake in Norilsk Nickel, the world's No. 1 nickel miner, for $7 billion and a 14% stake in aluminum producer Rusal in 2008. The bachelor, who practices kickboxing, likes to party in Moscow nightclubs.

2 ROMAN ABRAMOVICH
Top shareholder, Millhouse

AGE 43

EST. NET WORTH $17 billion

BUSINESSES Gold, steel, football

NEW TOY The *Eclipse* yacht

■ After becoming a father for the sixth time last year, Abramovich and his partner, socialite Daria Zhukova, celebrated New Year's Eve at his Caribbean estate on the island of St. Barts, hosting guests including actress Lindsay Lohan and economist Nouriel Roubini. Abramovich is awaiting delivery of his third yacht, the 557-foot, $400 million *Eclipse*, which will be the world's biggest. (He denies rumors it has an antimissile system.) Abramovich recently swapped two gold deposits in the Arctic Chukotka region, where he was governor until 2008, for 1.5% of Canada's Kinross Gold and $165 million in cash. His investment group also holds 32% of Russia's Highland Gold Mining and 36% of the country's No. 2 steelmaker, Evraz Group. Abramovich is a regular at matches of England's Chelsea football club, which he bought in 2003.

3 MIKHAIL FRIDMAN
Chairman, Alfa Group

AGE 45

EST. NET WORTH $14.3 billion

BUSINESSES Banking, telecom, oil, retail

FREE TIME Active in Russian Jewish Congress

■ He started with a window-washing business in the late 1980s and now leads one of Russia's most powerful empires. Fridman was one of four shareholders who fought with BP over the management of oil venture TNK-BP last year. After a five-year conflict with Norway's Telenor over mobile-phone assets, Fridman declared a truce in October and said the two companies would merge their mobile operations in Russia and Ukraine. Each will own just over 38% of the combined entity, which will be Eastern Europe's No. 1 mobile provider. In his spare time, Fridman enjoys playing the piano for friends.

4 OLEG DERIPASKA
CEO, Basic Element; CEO, Rusal

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AGE 42

EST. NET WORTH $13.8 billion

BUSINESSES Metals, autos, oil, utilities, construction, insurance

PERSONAL Married to Boris Yeltsin's granddaughter

■ Deripaska entered the crisis with more than $20 billion in debt, but he may yet pull off a turnaround. The yoga-practicing tycoon ceded stakes in German builder Hochtief and Canadian auto parts maker Magna International to lenders. And he got a helping hand when state-owned VEB Bank awarded aluminum producer Rusal, which Deripaska controls and runs as CEO, with a $4.5 billion bailout loan. Last year, Deripaska hammered out an agreement with Rusal's creditors to extend repayments on its $17 billion in debt. That allowed the company to raise $2.2 billion in an IPO in Hong Kong in January. (The shares are down 24%.) Now Deripaska plans to expand in China. He's not looking much to the U.S., where he has been questioned about alleged ties to the Russian mob, which Deripaska denies.

5 VAGIT ALEKPEROV

President, Lukoil

AGE 59

EST. NET WORTH $10.7 billion

BUSINESSES Oil, refining, retail

FREE TIME Fishing, tennis, travel

■ Alekperov scored a coup in January when Lukoil, Russia's largest nonstate oil producer, signed a contract to develop an Iraqi oil field that could in time pump 1.8 million barrels per day—as much as the company's Russian operations. Known for his rigid style (he has banned jeans from Lukoil's glass skyscraper in Moscow), Alekperov was the Soviet Union's first deputy oil minister when the country broke up in 1991. He soon left the government and set up Lukoil in 1993. Alekperov is the largest individual shareholder with about 20%; ConocoPhillips also owns 20%. He has said he hopes his son, Yusuf, now a student, will inherit the top job.

6 VLADIMIR POTANIN

President, Interros Holding

AGE 49

EST. NET WORTH $10 billion

BUSINESSES Metals, banking

SIDELINE TV personality

■ Potanin has played the Donald Trump role in a Russian version of *The Apprentice*, but his chief asset isn't real estate. It's Norilsk Nickel, which had an estimated $9.7 billion in revenues last year. The tycoon recently announced he will donate most of his fortune to charity within 10 years, following in the footsteps of Bill Gates. Potanin faces a tough battle to hold onto Norilsk as another shareholder, Rusal, clamors for a merger to create a Russian rival to mining giant BHP Billiton. The Kremlin would likely decide Potanin's role in a new entity.

7 VIKTOR VEKSELBERG

Chairman, Renova Group

AGE 52

EST. NET WORTH $8.4 billion

BUSINESSES Aluminum, oil, natural gas, renewable energy

FREE TIME Art collecting

■ Vekselberg is in a clash with Swiss authorities, who in January slapped him with a $38 million fine stemming from his purchase of shares of Swiss technology company Oerlikon in 2006. The charge, which he denies, is that he did not declare he was acting with others when buying the shares. Russian Finance Minister Alexei Kudrin called on the Swiss to review the fine or risk damaging the nations' ties. Vekselberg has also invested in Switzerland's Sulzer, an equipment maker, and in real estate developer Züblin Immobilien Holding. He plans to spend $1 billion on renewable energy projects in France, Italy, and Germany and to build a solar panel plant in Russia. After making headlines by purchasing nine Fabergé eggs to bring back to Russia in 2004, he has spent $100 million in the past four years to expand his collection with Russian paintings, porcelain, and silver.

8 ROUSTAM TARIKO

Founder, Russian Standard

AGE 47

EST. NET WORTH $1.6 billion

BUSINESSES Vodka, banking

SIDELINE Miss Russia Pageant

■ Tariko started as a Moscow street sweeper and now heads a vodka and banking empire under the brand name Russian Standard. Tariko aims to overtake Pernod Ricard's Absolut in three years and later outpour Diageo's Smirnoff. The chief sponsor of the Miss Russia Pageant, he features its winners in his company's advertisements and at his lavish parties. |BW|

PHOTO-ILLUSTRATION BY DOUGLAS B. JONES, PHOTOGRAPHS BY NIKISHIN/GETTY IMAGES (PROKHOROV); POLARIS (ABRAMOVICH); SAVERKIN/ITAR-TASS (FRIDMAN); ZEMLIANICHENKO/BLOOMBERG (DERIPASKA); HOSLET/EPA/CORBIS (ALEKPEROV); SAVERKIN/ITAR-TASS (POTANIN); SCHNEIDER/CORBIS (VEKSELBERG); GRIGORY/ITAR-TASS (TARIKO)

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Zynga, which makes FarmVille and other games, has more than 240 million users a month

STRATEGY & COMPETITION

Who Wants to Buy A Digital Elephant?

Sales of virtual goods are taking off. And it's not just kids who are buying

By Ari Levy and Joseph Galante

A few months ago, Nita Flores—a 38-year-old health-care worker—began playing games on Facebook and spending real money on her virtual life. Though the games are free to play, Flores spends about $20 a month for extras like virtual outfits for her cat in Pet Society and a stable for her horses in FarmVille. The games are "very entertaining and relaxing after a hard day," says Flores, who lives in Queens, N.Y.

For years gamemakers mostly targeted the millions of young males who spent $50 and up for sports and shooter games to play on Sony's PlayStation or Microsoft's Xbox. Now an increasing number of folks of all ages and both genders are minding digital farms, aquariums, and restaurants on social networks. The real growth in the games game is catering to their need for so-called virtual goods. Small amounts, like the 25¢ players pay for a plum tree on FarmVille or the dollar they pay for soup spices on Restaurant City, add up. Analyst Atul Bagga of the research firm ThinkEquity expects sales of virtual goods in the U.S. to almost double this year, to $1.6 billion. Women 35 and older, like Flores, are the "sweet spot," he says.

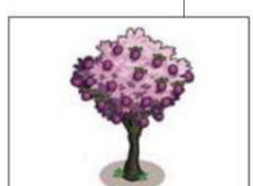
Startups such as Zynga and Playdom, which make some of the most popular games, are positioned to profit. Zynga, maker of FarmVille and other games, has a total of more than 240 million users per month, while social network games created by CrowdStar and Electronic Arts' Playfish each have more than 50 million. In comparison, Nintendo has sold a total of 67 million of its popular Wii consoles since they were introduced in 2006, though of course the consoles cost $200 or more while Zynga's games are free. Traditional game sales are in decline, with U.S. sales of consoles, games, and accessories dropping 13% in January, according to researcher NPD Group.

PROMISE TO PAY

According to Bagga, only 1% to 4% of the people playing games on social networking sites spend for virtual goods. Now a wave of Silicon Valley startups is trying to make it easier for people to do so. Boku, in San Francisco, and Zong,

VIRTUAL TOYS

A few of the props available in social games



Plum tree in FarmVille
25¢

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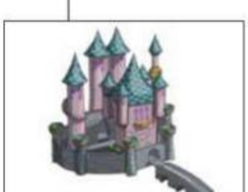


based in Palo Alto, Calif., have created applications so gamers can easily pay for virtual goods via a mobile phone. They are appealing to kids who don't have bank accounts or credit cards and gamers in countries where phones are more common than plastic. "If you make the process seamless, it's definitely going to help," says Bagga.

Earlier this month, Kwedit, a Mountain View (Calif.) startup, began selling software to game companies that allows users to get currency for games immediately if they promise to pay later. Players of the animal adoption game FooPets, for example, can get an advance of digital cash so they can buy virtual food and shelter. They then print out a voucher for the amount owed and go to the nearest 7-Eleven store to make the payment. If the player doesn't pay up, Kwedit stops extending credit. "There is a group of players out there who would pay if they could [find a way]," says Danny Shader, Kwedit's founder and CEO. "We can drive a ton of revenue to the Zyngas of the world."

The interest in virtual goods is widespread enough that some companies are offering digital currencies to attract new customers instead of the airline miles or coupons they may have used in the past. Netflix gives first-time customers currency for social games. Connie Lai, a 31-year-old blogger and freelance writer in the San Francisco area, saw such an offer from retailer Shoebuy.com just before the holidays. If she bought two pairs of shoes, she could get $10 in digital coins for Pet Society. Though Lai already spends about $50 a month on virtual goods, she was happy to get the promotion. "I have to buy Christmas gifts and Halloween gifts and Thanksgiving gifts for my friends anyway," says Lai. "I might as well get the points." | BW |

(RIGHT) PHOTOGRAPH BY JILL GREENBERG/CORBIS OUTLINE



Castle in FishVille
$1.40



Helicopter in Mafia Wars
$5.95

A CASH CROP FOR FACEBOOK

Keeping a piece of virtual goods sales could net it millions

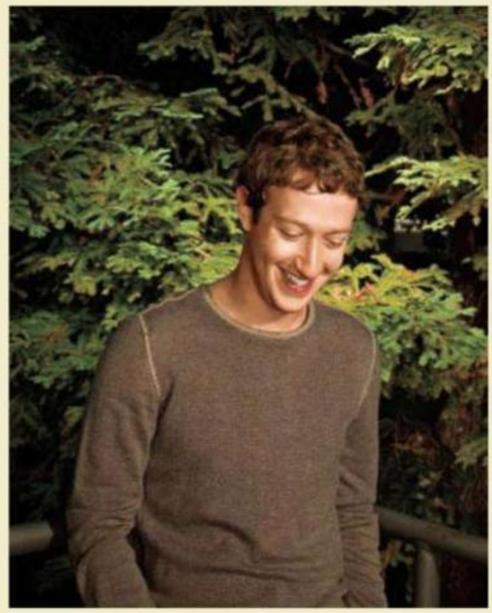
By Ari Levy, Brian Womack, and Joseph Galante

The price of a FarmVille tractor is $3.33. A box of fish food for Happy Aquarium sets you back $4.89. The tab for a helicopter in Mafia Wars is $5.95. And Facebook, headed by CEO Mark Zuckerberg, wants a cut of the action.

The giant social-networking site is testing a service that allows it to collect 30% of the sales of virtual game props, according to four people who have held discussions with the company. Facebook has relied to date almost entirely on advertising for revenue, but lately the market for game items has become too big to ignore. The research firm ThinkEquity estimates that sales of virtual goods and all the rest on social networks and mobile phones could quadruple, to $3.6 billion, in the U.S. by 2012. Today almost all such revenue goes to game developers, such as FarmVille's creator, Zynga.

For Facebook "it will likely be a significant revenue stream," says Jeremy Liew, a managing director at Lightspeed Venture Partners in Menlo Park, Calif., which invests in online social games.

Facebook is testing the payment option with 21 games through a service called Facebook Credits. The company will broaden the experiment with more games before its annual developers conference in April, according to people who have discussed the plans. "We are continuing to look at ways to extend our virtual currency—Facebook Credits—via a small alpha test," Facebook said in an e-mailed statement. "The test started in May and is exploring ways for people to use their Facebook Credits with third-party applications."



Zuckerberg is said to want a 30% cut of the sales of virtual game props

The most popular networking site, with 400 million users, Facebook is following the lead of Apple, which gets a 30% share of sales of applications on its iPhone. At present, people playing games on Facebook can obtain props via third-party payment services or use the nascent Facebook Credits system. The games themselves are free.

Atul Bagga, a ThinkEquity analyst in San Francisco, says that if all game payments on the site shifted to Facebook Credits, the company could collect as much as an additional $530 million in revenue over three years. The reason players might make the move, he adds: "You trust Facebook more than you would trust any other payment company." | BW |

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PERSONAL BUSINESS

MONEY REPORT

AN ICY OUTLOOK

Stocks are poised to enter a long-term "Ice Age," according to Société Générale global strategist Albert Edwards. Both the Economic Cycle Research Institute's weekly index of leading indicators for U.S. growth and the Organization for Economic Cooperation & Development's monthly gauge of economic measures for China have peaked, Edwards wrote in a recent report. Such high points foreshadowed the stock market sell-off that began in October 2007 and sent the MSCI All Country World Market Index down as much as 60% in 16 months. The strategist recommends holding 35% in stocks, 50% in bonds, and 15% in cash. His report follows one by Ian Gordon, a strategist at Longwave Group in Surrey, B.C., on Feb. 9 saying the Dow Jones industrial average could fall 90% over three years as U.S. equity markets move deeper into the "winter" phase of a half-century economic cycle. Gordon said the Dow is likely to bottom in 2012 and that "winter" may last until 2020.

90%

Potential drop in the Dow that Ian Gordon, strategist at Longwave Group in Surrey, B.C., sees over three years

STOCKS

THE TRACTOR FACTOR

Deere didn't just beat expectations on Feb. 17. It slaughtered them. Net income rose to 57¢ a share, leaving analysts' average calls of 19¢ in the dust. Its stock rose 5%, to 56.48, on news of its first-quarter profit. Deere also raised its 2010 forecast and expects equipment sales to gain 6% to 8%, compared with the 1% decline it forecast last November.

Analysts at Credit Suisse, JPMorgan Chase, and Morgan Stanley say the stock could hit 65 to 70 over 12 months as demand overseas and efforts to replenish U.S. inventories spur production. "Foreign demand growth continues to be very strong, particularly from Asia, and we're starting to see capital spending pick up," says JPMorgan Chase economist Michael Feroli. Ways to play the trend: Vanguard's Industrials Exchange Traded Fund, up 3% this year, and the Industrial Select Sector SPDR ETF, up 4%. The S&P 500 is down 0.3%.



FRESNO BEE/ZUMA

Demand for goods like this Deere harvester is likely to rise

THE FED

WHAT THE HIKE MEANS

The Federal Reserve's decision on Feb. 19 to raise the discount rate, which it charges banks for loans, dampened demand for riskier assets. The Fed said the quarter-point bump, to 0.75%, will encourage financial institutions to rely more on money markets, instead of the central bank, for short-term liquidity. The move "rocked the markets," says Crédit Agricole CIB strategist Stuart Bennett, as foreign indexes—including Brazil's Bovespa—fell while the U.S. dollar hit a seven-month high. These moves don't necessarily mean investors should flee to safe havens. Channel Capital Research chief investment strategist Doug Roberts says to stick with what you've got, "unless the Fed embarks on a massive tightening spree." The discount rate rose from 2% to 6.25% from June 2004 to June 2006. Over that time, the S&P 500 returned 15% and the MSCI EAFE Index 37%. The Barclays Capital U.S. Aggregate bond index climbed 6%.

An Icy Outlook: Adam Haigh, Michael Patterson, Alexis Xydias; The Tractor Factor: Tara Kalwarski, Will Daley, Bob Willis, Timothy R. Homan; What the Hike Means: Tara Kalwarski, Laura Cochrane, Veronica Espinosa, Craig Torres

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SECOND ACTS

THE ROAD TO REINVENTION

By Amy Feldman



A writers' strike. A pink slip. The death of loved ones. For Marla Ginsburg, Todd Morris, and Kate Curran, these things sparked near-complete reinventions of their working selves. It's a process many Americans are wrestling with as the economic downturn seals off traditional career paths and forces workers, especially older ones, to get more creative about making a living. The financial trade-offs can be huge, but so can the satisfaction of taking a risk and landing on a new path. Here's how three people re-created their careers after professional or personal setbacks.

MARLA GINSBURG 54

Marla Ginsburg had been a successful TV producer for two decades, with shows that included *La Femme Nikita*, when her life was disrupted by the three-month writers' strike that paralyzed Hollywood in 2007. She had no money coming in, two teenagers at home, and an unsettling sense that she couldn't go much further as an aging woman in an industry that favors the young. "I thought, if I could do anything else in the world, I'd love to have a talk show or design clothes," says Ginsburg. "They both seemed like such outrageous things to do. But there was nothing going on, so I went into a store and bought fabric." She didn't know the clothing business, and she'd never even sketched. But Ginsburg did see a real need: There weren't any clothes that she,

(BOTTOM) ROBERTO FRANKENBERG



INSEAD professor and author Ibarra researches work identity issues

FIND A NEW WORKING SELF

You can read lots of career books and plot myriad strategies with a coach, but the key to reinvention is this: stop agonizing and do something. That's the view of Herminia Ibarra, professor of organizational behavior at international business school INSEAD and author of *Working Identity*. In Ibarra's view, people reinvent through trial and error. But does that messy path to change, seen in sunnier times, still work in these days of financial uncertainty? Amy Feldman spoke with Ibarra, who is working on a second book about leadership and identity. Excerpts from their conversation are below.

What distinguishes those who succeed at reinvention from those who fail?

Networks have a lot to do with it. Some people live in a very insular world where they live, eat, and breathe with people who are like them. They are lawyers in the company of other lawyers. It's really hard to figure out what you want in that context because you have no fresh ideas coming in, and everybody reinforces the value of staying in that career. [Those who succeed are] people who are curious and open to reaching out to others. That gives them glimpses

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Ginsburg swapped life as a TV producer for clothing design

(TOP) ETHAN PINES

as a fashionable middle-aged woman, wanted to wear. "There were all these grandma clothes out there, and I'm a boomer," she says.

In 2008 she launched Boombacouture, with funding from a clothing manufacturer with a factory in Peru. The clothes sold to Nordstrom and specialty stores, Ginsburg says, but before the end of that year, with the economy in decline and consumer spending way down, her funder abruptly backed out.

Boombacouture was done, but Ginsburg's brief entrepreneurial stint bridged her to a new career. Last July, she was hired as creative director by FDJ French Dressing, a Canadian company that makes jeans for older women. FDJ had gone through its own financial troubles and restructured under new management.

Ginsburg sold her house in California at a loss and moved to Montreal with her kids. "Whoever thought that getting older could become a career?" she says with a laugh. The clothes she designs are made from fiber blends that are more breathable than cashmere and other wools, which helps them stand up to machine washing—and accommodate a menopausal woman's hot flashes. "I could have stayed in the entertainment industry, but I knew my shelf life," she says. "Even if I could have squeezed a few years out of it, I was done. I miss the money, but a whole new life came."

TODD MORRIS 39

Todd Morris spent the first dozen years of his career selling software for companies like Apple and Adobe. Seven years ago, while planning a 15-day rock-climbing trip in Thailand, he got the call no employee wants: His employer, Pumatech, was letting him go. He ended up turning his 15-day trip into a nine-month journey through Asia, funded by renting his New York apartment. He didn't have much of a plan for what he'd do when he got back.

Returning home, Morris started consulting

of other possibilities. People can clearly identify what they don't want to do and what doesn't fit them. They have a harder time saying, this is what I want to do.

So it's about sorting through an amorphous sense of wanting to change?

Exactly. Once you have leads, you can network into them. You can figure out who you know, or what conferences to attend, or what courses to take. Much harder is to actually get the idea [of what you want to do]. My impression is that [this process] is still very much the same, but it can take longer in this downturn because there are fewer jobs to be had.

Unemployment statistics for older workers are grim. What would you say to older workers out of a job?

I have a sense that a lot of people in that age bracket start their own businesses to leverage their experience. That tends to be more successful than getting hired elsewhere, because that means getting hired at a lower salary—and getting hired, period, is very hard now. There's a lot of opportunity for people who have entrepreneurial skill because organizations are running lean and doing things off payroll. People also often end up having bridge careers that help them pay the bills until they can get back on their feet and explore more appealing avenues.

Is there a window during which people can reinvent careers? And if you don't act within that time, it closes?

There is something to that. People who go back to school midcareer hope to reinvent themselves. But the job offers made to them at the end are often disappointingly close to what they had before. There's a danger period because you have [new] credentials, but if you go back to the same thing, what will be the bridge to the new? When you lose your job, it's a longer process because it's a loss of identity, and there's a need for real repair.

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LIFE MANAGEMENT



Morris left a career in software sales to start a business selling surveillance equipment

and getting back into the software business. It wasn't long before Macromedia, a software company that was subsequently acquired by Adobe, offered him a job, and he realized he just couldn't continue on the same career path. It wasn't a well-thought-out process, just a realization that struck after the time he'd been away. "I would have felt like I was going backwards if I'd taken it, even though it was a higher-level position," recalls Morris. He turned down the job.

Some people might have done a lot of research or worked up a business plan. Morris, a gadget geek, simply decided that since he didn't see a dominant player selling security and surveillance products—including computer security products, tracking devices, hidden cameras, and pretty much anything else that isn't a home alarm—he'd try to fill that niche. So in 2005 he founded BrickHouse Security, an online retailer, launching with only two items for sale.

Morris proposed to his then-girlfriend, Bing, the same month he started the company. They married later that year and now have a three-year-old son and a second child on the way. Morris says those expanding family responsibilities have given him focus and drive. The privately held and self-funded company now generates $12.5 million in revenues and has 34 employees. "Coming out of a big company, it was kind of like having a baby," he says. "You're never going to be ready. So don't spend a year on a business plan. Just f***ing do it."

"COMING OUT OF A BIG COMPANY, IT WAS KIND OF LIKE HAVING A BABY. YOU'RE NEVER GOING TO BE READY"

KATE CURRAN 46

Sometimes a spark of an idea sets off a career reinvention. For Kate Curran, the impetus for change was tragedy—her parents and a brother died within 20 months. "I just knew that what I was doing did not work for me any longer," says Curran, who worked in government relations, shuttling between Connecticut and Washington, D.C., for General Electric. "I was fairly traumatized and decided to take some time off."

Curran quit in July 2007 and six months later began traveling to Argentina, Tanzania, Spain, and elsewhere. When not traveling, she worked with a career coach and did exercises from the career classic *What Color Is Your Parachute?* At the end of 2008, Curran, who has also practiced law and been a fund-raiser for the Boy Scouts, knew she wanted to do international development work and thought she wanted to set up her own organization—a tough financial proposition. To make her plan work, Curran, who is single, moved in with a sister in Milford, Conn. In May, along with Spanish TV producer Jose Luis Feliu, she co-founded The Giving Project to build schools, footbridges, and water recycling projects in developing countries. One of their first projects, a school for 120 children in the Guatemalan highlands of Chichicastenango, will open in the spring.

Her goal for the next few years is to build the nonprofit so that it can set up more schools and bridges—and pay her a salary. Curran says shifting to nonprofit work from a well-paid corporate job has in some ways been easier during the recession, since others are asking similar questions about their lives and consumption patterns. "I can see genuine fear of the process of change in the people I talk to," she says. "For me, it was not like that." |BW|

MATTHEW FURMAN

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INVESTING

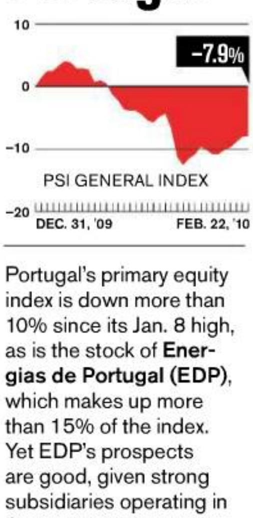
FOREIGN STOCKS

PEARLS AMONG PIIGS

By Tara Kalwarski

Swelling budget deficits and widening trade imbalances in Portugal, Ireland, Italy, Greece, and Spain have earned these nations the unflattering name "PIIGS," as well as mostly negative outlooks from the major credit-rating agencies. Bad publicity and elevated risk have caused equity investors, fearful of another liquidity crisis, to sell off holdings. That has pushed down prices, creating buying opportunities for those who know where to look. Here are some industries and companies that fund managers familiar with these countries say they're hanging on to—and some they're avoiding.

Portugal



Portugal's primary equity index is down more than 10% since its Jan. 8 high, as is the stock of **Energias de Portugal (EDP)**, which makes up more than 15% of the index. Yet EDP's prospects are good, given strong subsidiaries operating in Spain, Portugal, France, and Belgium, says **New Alternatives Fund** manager David Schoenwald. About 5% of his holdings are in EDP's alternative-energy subsidiary **EDP Renováveis**. At 3.5% of holdings, the highly rated **Columbia International Value Fund** has one of the biggest stakes in Portugal, according to Morningstar. Its No. 2 holding is **Portugal Telecom**.

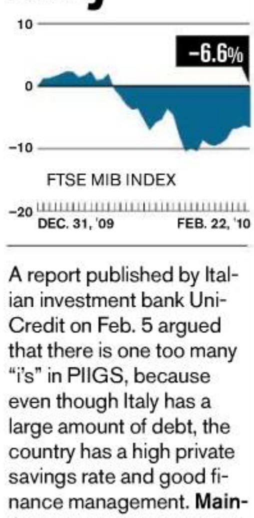
Ireland



Stocks in Ireland seem little affected by the nation's economic turmoil—so far. The Irish Overall Index is flat for the year, while the MSCI index that tracks Europe is down 2%. **T. Rowe Price European Stock** manager Dean Tenerelli explains that Ireland is trying to solve its problem the "hard core" way with big budget cuts. "It means their economy will slow down dramatically," he says. That could suggest a sluggish stock market.

Want to play anyway? About half of **AIM European Small Company Fund's** 8% Ireland stake is in **DCC**, a holding company with investments in food, energy, and health care.

Italy



A report published by Italian investment bank UniCredit on Feb. 5 argued that there is one too many "i's" in PIIGS, because even though Italy has a large amount of debt, the country has a high private savings rate and good finance management. **Main-Stay Epoch International Small Cap** manager Emily Baker tends to agree, noting that Italian companies make up about 8% of total holdings right now. "The fear is overdone," she says. The fund owns railway and subway builder **Ansaldo STS**, which collects more than 50% of revenues from outside Italy and has a strong backlog of orders. European banks, however, are not in the portfolio.

Greece



The situation in Greece is dire, as you can tell from the Athens Stock Exchange General Index, which has lost about a third of its value since peaking in October. But T. Rowe Price's Tenerelli doesn't expect the country to default on its debt and has about 2.5% invested in Greece. "It is a great time for buying quality companies that don't have a lot of debt and have good business models." He likes **National Bank of Greece**, one of the few banks, he says, whose loans don't exceed deposits. Tenerelli also likes toy retailer **Jumbo**, which trades at about 10 times earnings.

Spain



One-fifth of **McKee International Equity's** portfolio is in stocks from PIIGS countries, and half of that is in Spain. Manager William Andrews likes **Telefonica**, citing significant sales coming from Latin America. He says it would be a mistake not to invest in companies just because they come from a PIIGS nation. "I think the market is a little too fixated on the PIIGS." He's bearish on any European company whose bottom line is hugely dependent on the Continent. The fund's top holding is **Banco Santander**, which gets more than half its profits from outside the euro zone. Not in the fund: Spanish construction companies.

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76 Books: Menn's *Fatal System Error*
78 Feedback:
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TECH & YOU By RICH JAROSLOVSKY

Browser Wars: The Sequel

Chrome, Safari, IE 8, Firefox, Opera...there's never been a better time to explore your options

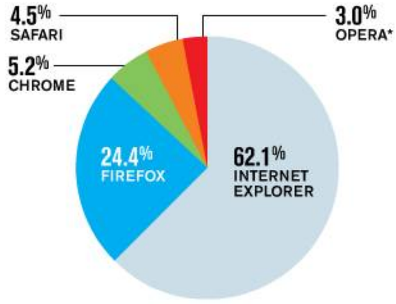
For the first time in years, energy and resources are being poured into browsers, the ubiquitous programs for accessing content on the Web. Credit for this trend—a boon to consumers—goes to two parties. The first is Google, whose big plans for the Chrome browser have shaken Microsoft out of its competitive torpor and forced the software giant to pay fresh attention to its own browser, Internet Explorer. Microsoft all but ceased efforts to enhance IE after it triumphed in the last browser war, sending Netscape to its doom. Now it's back in gear.

There's also the European Union to thank. Starting this month, Brussels will require PC makers to give customers who buy new computers in Europe more freedom to choose. Under this plan, part of an antitrust settlement with Microsoft, purchasers will be presented with a screen at startup listing a dozen browsers in random order.

You don't have to be European, or even to have just purchased a new PC, to download these free programs and start exploring. When you do, there a few things you should keep in mind, especially regarding security and privacy.

Every company trumpets its strengths in security, but the term "secure browser" is a bit like "safe cigarette." Just months after releasing the latest version of Internet Explorer with a heavy emphasis on its security features, for example, Microsoft ac-

TAKING ON MICROSOFT



*Includes Opera Mini Browser for mobile devices
Data: NetApplications (Jan. 2010)

PETER ARKLE;
CHART BY STANFORD KAY

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knowledged that the hackers in China who targeted Google made use of an IE 6 security lapse.

Privacy is no more dependable. All browsers offer "inprivate" or "incognito" modes, but for the most part such settings only seek to prevent people who might look at your computer from seeing the sites you have browsed; they don't stop those sites from keeping records of your visits.

It's important to keep in mind why companies give their browsers away for free. Chrome, for instance, is a key part of Google's strategy to get computer users comfortable with so-called cloud computing. The idea is for everyone to spend less money and time on programs they license from software companies (Microsoft, say), and rely more on data and services such as Google Docs, which reside on servers and storage systems on the Net.

Described this way, Chrome—which is available in versions for Windows, Mac, and Linux—sounds like a stalking horse to make us all dependent on Google's own ad-driven services. Guess what? It is! But for Google's plans to work, Chrome has to be good. And it is. The program is fast, takes up little space on your hard drive, and rests lightly atop your computer's operating system. These are fine things, from a security standpoint, and should make Chrome attractive to corporate tech administrators as well as civilians.

Mac users should have no problem choosing a browser. The best one is Apple's own program, Safari, and it comes with every Mac. (Microsoft got into antitrust trouble for doing this with IE; presumably, Apple gets away with it because its market share is so much smaller.) Safari is also available in a Windows version, but I still seem to run into too many Web sites that haven't taken the trouble to make themselves Windows-Safari-friendly.

When working in Windows, I like to use Mozilla Firefox, a descendant of Netscape. Maintained by an open-source community, Firefox is available for PCs, Macs, and Linux systems, and is the second-most-used browser after Internet Explorer. The program benefits from a well-developed ecosystem that includes many thousands of add-ons for everything from speeding up YouTube downloads to StumbleUpon, which helps you discover and share Web sites that match your interests.

Opera is also a good choice. It's from the Norwegian company Opera Software, which has been around since the earliest days of the Web, and is available in Mac, Linux, and PC versions. And of course, there's Internet Explorer itself. The current version, IE 8, was released last year with a slew of enhancements, and Microsoft has promised that the next version will be faster and even harder for bad guys to hack into.

Each browser has legions of fans, and I'm not dumb enough to try to tell you which is best for you. I don't want all that hate mail from devotees of the other browsers whom I offend. What I'll say is, this is the perfect time to break the shackles of habit and try something different. Better still, try them all. | BW |

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Aid For The Ignorati

What's the biggest factor keeping computer users from switching browsers? Software makers other than Microsoft say it's ignorance. To many people, that big "e" icon for Microsoft's Internet Explorer simply means "the Internet," and they aren't aware of the alternatives. To clarify, Google has created a Web site (http://www.whatbrowser.org) with links to five browsers—Microsoft's and Google's among them—along with a video, benchmark tests, and more.

To check out the site, go to **http://bx.businessweek.com/google-chrome/reference/**

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BOOKS

By PETER BURROWS

Why the Hackers Are Winning

Corruption and official protection make it tough to stop cybercrooks and spies

Ivan Maksakov was a skinny, shaggy-haired, 21-year-old living with his parents in the nowhere Russian town of Balakovo. Then he taught himself how to break into computers worldwide. When Russian mobsters discovered his talents for crashing gambling Web sites unless they paid up, they made him one of their own. But on July 20, 2004, British and Russian authorities raided houses in three Russian cities and arrested Maksakov. After agreeing to tell all, he later shocked prosecutors by changing his testimony and pleading not guilty. Ultimately, he and two others got eight years of hard labor for their crimes.

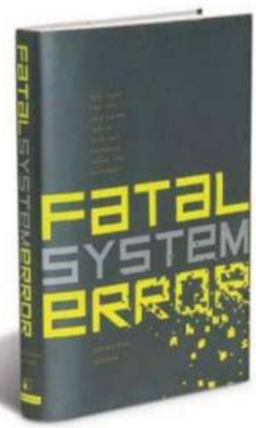
Maksakov's tale gets told about halfway through Joseph Menn's excellent book, *Fatal System Error: The Hunt for the New Crime Lords Who Are Bringing Down the Internet*. What makes the story so chilling is that the successful prosecution of this low-level scamster stands as a climactic achievement of the cybercrime-fighters profiled in the book. Nabbing Maksakov was about the best they could do.

While Menn provides rich detail about a cast of more dangerous criminals, he also illustrates the many reasons so few are brought to justice—lack of cross-border jurisdiction, payoffs to local politicos, and protection from officials more interested in exploiting than punishing hackers' techniques. "The Russian government, and possibly the Chinese government, [have] access to minds capable not only of stealing millions upon millions of dollars, but potentially disrupting the Western economy," writes Menn, a staffer for *The Financial Times* and a former reporter for Bloomberg News. "Why wouldn't they encourage additional research to nurture such a weapon?"

Such statements may have once sounded outlandish, but no more. Google recently announced that it and dozens of other Western companies had been victims of what may be state-sponsored hacking in China. And Menn makes a compelling case that Moscow knows hackers affiliated with a group called the Russian Business Network were responsible for the shutdown of the Internet in Estonia in 2007 and in the Republic of Georgia just before Russia's invasion in 2008.

All this makes *Fatal System Error* timely. It's also a rollicking read, built around two unlikely good guys. The first half focuses on Barrett Lyon, a dyslexic computer nerd from California who as a young teen accidentally brought AOL to its knees for three days. Soon after, in 2002, he created a company to use his hacking genius to help corporations stave off attacks. Along the way he meets Andrew Crocker, a onetime street tough and boxer who helped create Britain's National Hi-Tech Crime Unit. With Lyon's help, Crocker is able to set up shop in Russia, where he chugs vodka with enough of the right lawmen to win those rare convictions. But time and again, he and a Russian sidekick get agonizingly close to catching big-time bad actors and are foiled by what Crocker believes to be corruption.

Menn's real achievement is that he entertains as he educates. One reason cybercrime persists is that it's too unfathomable to the general public to generate much anger—despite the fact that experts think it could be costing that public as much as $1 trillion a year. Readers may not follow every keystroke of Menn's story, but they'll retain enough to get scared.



Fatal System Error: The Hunt for the New Crime Lords Who Are Bringing Down the Internet **by Joseph Menn; PublicAffairs; $25.95; 281 pp.**

The book ends with an uncharacteristically dry account of what should be done to stop cybercrime. Among Menn's ideas: legalize and regulate online gambling; fund school programs to teach safe computer use; and overhaul the Internet itself—possibly including a federal ID program that would prevent people from getting online anonymously.

Menn also calls for more vigilance from everyday Web surfers (story, p. 52). "The people who won't let their lawns go uncut out of respect for the neighbors need to realize that turning on a home PC without a strong firewall and without an operating system and antivirus software that each update automatically is like leaving a loaded shotgun on the front porch for passersby," he writes. "It almost guarantees that their computers will be compromised and used for nefarious activities." | BW |

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FEEDBACK

THE OBAMA INTERVIEW

NOW THE PEOPLE HAVE THEIR SAY

Regarding "Obama's Corporate Messaging" (In Depth, Feb. 22): I thought Obama came across as sincere about how he views his Administration's support of business. However, he misses a much bigger picture about why his Administration is viewed as anti-business. There are three big reasons why businesses, especially small and medium-size, are worried.

First, there is all the uncertainty raised from the vast legislative agendas his Administration proposes, whether it be health care, energy policy, trade, unionization, increased regulation of the financial sector, or increased OSHA, IRS, and EPA rules. How can any business plan for the future in this environment? If Obama wants to be more friendly to business, he needs to change the legislative process from one of advocating major overhauls to one of incremental improvements that can be digested by the business community.

The second issue is local, state, and federal deficit spending. While the U.S. has always been a debtor nation, we have reached the tipping point in two realms. One is the level of debt to GDP, which is at the point where most economists predict slower growth. Though we have hit this point before, mostly notably during and after World War II, that was a unique time in history where postwar growth was all but assured because the number of developed nations was much smaller. Now we are back to the same levels of debt, but in a world with a much greater number of first-world economies.

Lastly, while the Administration and Congress frequently lament the loss of manufacturing jobs to overseas countries, they have no trouble with offshoring our most basic material needs, oil and minerals. With the vast prohibitions against oil and mineral extraction, we take away a fundamental part of our economy and hand it over to others.



All these issues leave me with a view of the future that has less opportunity for us than we had in the past. If Obama truly wants to be a pro-business President, he needs to better discern the type and quantity of legislative proposals that create or diminish opportunities and risk-taking. Until then, my money is on places like Singapore, Australia, and Vietnam, which are becoming better structural models for business development than the U.S.

Arthur Leman
HARLEYSVILLE, PA.

As a small business owner, I am very nervous about making key business decisions (capital investment, hiring, new product development, etc.) given the high uncertainty over the Administration's proposed tax policies: a tax on private health insurance, a bank tax (or Financial Crisis Responsibility Fee), raising top income tax rates, a value-added tax, increased Social Security taxes, taxing employer-provided health benefits, cap and trade, restoring the estate tax, raising taxes on overseas corporate earnings, an income tax surtax, and the list goes on. Mr. Obama's quote, "we are pro growth," perplexes me. The disconnect with the American people lies in the fact that his actions speak so loudly, we can't hear what he's saying.

Gary Medved
LYNDHURST, OHIO

Can you stop the Obama lovefest? How many times is his picture going to be on the cover of *Bloomberg BusinessWeek*, and how many more "exclusive" interviews must we read? Enough already! I thought you were business journalists, not Obama groupies.

If I want an Obama lovefest, I go to CNN. If I want business news, I go to *BusinessWeek*. Or at least I used to.

Calvin Miles
BOCA RATON, FLA.

CORRECTIONS & CLARIFICATIONS

"Now, an Alternative to Alternative Energy" (What's Next, Mar. 1) said nearly 8,000 megawatts of new wind capacity were installed in the U.S. in 2009. The correct figure is 9,164 megawatts.

"The Fakery of CEOs Undercover" (Television, Feb. 15) said Donald Trump's TV series *The Apprentice* is defunct. *Celebrity Apprentice* starts a new season on NBC on Mar. 14.

"India: Nobody Loves the Mobile Net" (What's Next, Feb. 15) incorrectly stated that Russia's MTS bought 74% of India's Shyama TeleServices. The stake was bought by Sistema, the majority owner of MTS.

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COMPANY INDEX

The index lists significant references to companies, top executives, public officials, and well-known figures around the globe.
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OUTSIDE SHOT

By PATRICK McGURN

The Power of Shame This Proxy Season

Tougher SEC rules on CEO pay disclosure could lead to old-fashioned public humiliation. And that's a good thing

Many people can recite the first half of Louis D. Brandeis' quote about the cleansing qualities of disclosure—"Sunlight is said to be the best of disinfectants .... " Few bother with the rest of the sentence, in which Brandeis calls "electric light the most efficient policeman." To her credit, Securities & Exchange Commission Chairman Mary Schapiro seems to have both sides committed to memory.

One of the priorities of any SEC chair is to address investor and market concerns before populist anger spurs overreactions on Capitol Hill (think Sarbanes-Oxley). Following the Wall Street bonus binge of '09, Main Street anger over CEO pay is at an all-time high, and before things get too out of hand, Schapiro has put compensation under the lamp.

She and her deputies have used recent appearances at legal conferences to spell out their expectations for full compliance with executive pay disclosure rules. And there's growing anticipation that the SEC will make an example of an uncooperative company or two this proxy season. Schapiro, it should be noted, has a newfound perspective on the power of public exposure: Her former employer, the Financial Industry Regulatory Authority, failed to fully disclose her rich payout of $7.3 million, which some in the blogosphere have derided as being downright Dick Grasso-esque.

Tougher standards were adopted in July 2006 by then-SEC Chairman Christopher Cox, but his lieutenants failed to hold most issuers' feet to the fire on linchpin disclosures related to performance targets and benchmarking. As a result, corporate lawyers began to treat the cops at SEC's Corporation Finance Div. with the kind of respect reserved for Barney Fife—except that given the SEC's limited resources and Cox's failure to provide adequate backup, Corp Fin lacked even the single bullet Sheriff Andy Taylor allowed Barney to carry in his shirt pocket.

The ground started to shift last June when Schapiro proposed post-meltdown pay disclosure changes to focus "further sunshine on compensation decisions." These rules, which call for more information about possible links between pay practices and excessive risk-taking and breakouts of revenues received by "independent" advisers to board pay panels, were adopted in December.

With Schapiro watching their backs, SEC staffers started acting a lot more like Dirty Harry, uttering "make my day" warnings to issuers and their advisers. In a Nov. 9 speech, Corp Fin Deputy Director Shelley Parratt reset the bar for 2010. "Our expectations for quality disclosure are heightened," Parratt said. "We expect companies and their advisers to understand our rules and apply them thoroughly." Overnight, scores of lawyers dashed off client memos transforming Parratt's words into what now passes for a backwards Miranda warning: Anything you don't say can and will be held against you.

After years of the SEC handing out "incomplete" grades and making head fakes, it appears the new sheriff really means business. Company advisers report that SEC staff is providing swift pay-related feedback—even on preliminary proxy filings—and most companies are making changes in response. "A lot of companies that I've talked with are beefing up their disclosure," noted one SEC alumnus who advises boards. Upgraded compensation-related proxy disclosures, with more graphs and charts detailing the link between pay and performance, are flowing into the SEC's mailbox, based on what I've seen posted on its EDGAR Web site.

Last May, Warren Buffett told the attendees at his annual "Woodstock for Capitalists" that the best way "to get big shots to change their behavior" surrounding executive pay "is to embarrass them." It appears that the mere threat of humiliation does the trick just fine, though a few companies are certain to dig in their heels.

The context of Brandeis' sunlight insight is often forgotten. Contrary to popular wisdom, the reference isn't from a court decision. It was buried in a series of 1913 *Harper's Weekly* articles that focused on—you guessed it—banking reform and the failure of corporate governance. Those essays were collected into a 1914 book titled *Other People's Money*. How appropriate. | BW |

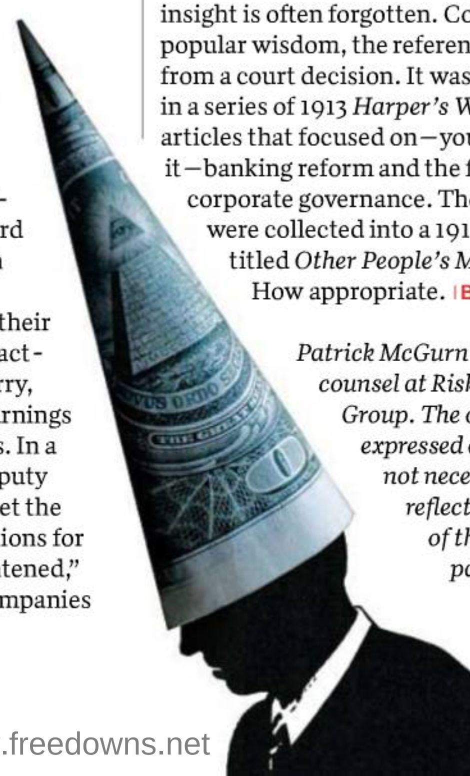


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